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HOME MORTGAGE DISCLOSURE ACT: NEWLY COLLECTED DATA AND WHAT IT MEANS

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

JUNE 13, 2006

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U.S. GOVERNMENT PRINTING OFFICE

31–528 PDF WASHINGTON : 2007

For sale by the Superintendent of Documents, U.S. Government Printing Office
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HOME MORTGAGE DISCLOSURE ACT: NEWLY COLLECTED DATA AND WHAT IT MEANS

Tuesday, June 13, 2006

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Baker, Garrett of New Jersey, Pearce, Neugebauer, Price, McHenry, Maloney, Watt, Meeks, Waters, Ford, Baca, Green, Clay, Matheson, and Frank (Ex Officio).

Also present: Representatives Davis of Alabama, and Lee.

Chairman BACHUS. Good morning. The committee will come to order. Today's hearing, which was requested by Ranking Members Frank and Sanders, Congresswomen Waters and Lee, and Congressman Watt, will focus on the recently implemented Federal Reserve Board regulation under the Home Mortgage Disclosure Act that requires mortgage lenders to collect, report, and make public new mortgage pricing data and what that data means for consumers and lenders.

The possibility of racial discrimination is a serious issue that deserves our attention. I am hopeful that today's hearing will shed some light on this issue. Owning a home is part of the American dream, and all Americans should be treated fairly when they try to make that dream a reality.

The Home Mortgage Disclosure Act was enacted by Congress in 1975 to provide the public with information to determine whether lenders are serving their communities to enhance enforcement of laws prohibiting discrimination in lending, and to provide private investors and public agencies with information to guide investments in housing. The Act, which was implemented by the Federal Reserve Board, requires most mortgage lenders located in metropolitan areas to collect data about their housing-related lending activity, report that data annually to the government, and make the data publicly available.

In 2002, the Federal Reserve Board required additional information to be reported for its 2004 data collection in order to improve the quality, consistency, and utility of the data reported. Most importantly, lenders must now disclose pricing, which includes inter-

est rates and fees for higher-priced loans. Other newly required information now being reported includes whether the loan is a first lien, a junior lien or unsecured, and whether it is secured by a manufactured home and if it is subject to the protections of HOEPA.

However, it should be pointed out that the data does not include or take into consideration certain risk evaluation factors used by lenders in determining whether to make a loan and at what price. Specifically, the data does not include the borrower's asset level or credit score, the loan-to-value ratio of the property, the borrower's debt to income ratio, or the level of documentation submitted.

Because of the limitations of the data, I, along with many members of the subcommittee, signed a letter requesting that the Federal Reserve examine more comprehensive data to assess the extent to which loan pricing is correlated with risk. With this enhanced information, the Federal Reserve and the Departments of Justice and HUD should be able to make a determination as to whether any disparity in loan pricing is based on discrimination or risk-based pricing.

Today's hearing will consist of two panels. First, we will hear from Federal Reserve Board Governor Mark W. Olson. On the second panel, we will hear from Dr. Douglas G. Duncan, senior vice president and chief economist, research and business development for the Mortgage Bankers Association; Ms. Janis Bowdler, housing policy analyst, National Council of La Raza; Mr. Bill Himpler, executive vice president, federal affairs, American Financial Services Association; Mr. Keith Ernest, senior policy counsel, Center for Responsible Lending; Mr. Calvin Bradford, president, Calvin Bradford & Associates on behalf of the National Fair Housing Alliance; and Dr. Michael E. Staten, director, Credit Research Center, McDonough School of Business, Georgetown University.

The reason for the second panel with six witnesses was to accommodate several members who had specific requests.

I look forward to hearing from today's witnesses and thank them for taking time from their busy schedules to join us.

In closing, I would like to thank Ranking Members Frank and Sanders and their staffs for working with us on this hearing. They are strongly committed to these issues, and I commend them for their efforts to ensure that lenders comply with fair lending laws and that discrimination does not occur in the marketplace. Violations of our fair lending laws should not be tolerated, and I look forward to working with them, with Congresswomen Waters and Lee, and Congressman Watt, in assuring that violations of our fair lending laws are exposed and violators brought to responsibility. I look forward to working with them and members of this subcommittee as we continue to examine predatory lending practices.

The Chair now recognizes Mr. Watt for any opening statement he would like to make.

Mr. WATT. Thank you, Mr. Chairman. Last week Representative Kanjorski asked me to substitute for him as the ranking member of the hearing because he was out of town, and today Representative Sanders asked me to substitute for him as the ranking member because he couldn't be here.

I think that there is a concerted effort to bring up the minor league on our side, those of us who are in training either for ranking member positions or chairmanships, we hope. So here I am again substituting, and I appreciate the chairman convening the hearing at our request.

I thank Ranking Member Frank and Representatives Sanders, Waters, and Lee for joining in the request, along with myself, that we have this hearing today.

The Equal Credit Opportunity Act prohibits, "any creditor to discriminate against any applicant with respect to any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, or marital status or age." Title 8 of the Civil Rights Act, Fair Housing Act, as amended, prohibits discrimination in the sale, rental, and financing of dwellings and in other housing-related transactions based on race, color, national origin, religion, sex, familial status, including children under the age of 18 living with parents of legal custodians, pregnant women, and people securing custody of children under the age of 18, and handicap disability.

The Federal Reserve uses HMDA data as a screening tool to identify disparities in mortgage lending that warrant closer scrutiny. Based on a review of 2004 HMDA data, the Federal Reserve reportedly identified about 200 lenders that demonstrated statistically significant disparities in mortgage lending. The Federal Reserve shared, on a confidential basis, the results of this analysis of lenders' 2004 HMDA data with other agencies that have supervisory or enforcement authority over these lenders for use in those agencies' supervisory or enforcement programs.

On March 17, 2006, in addition to requesting this hearing, Mr. Chairman, Representative Frank wrote to HUD, DOJ, OCC, FDIC, OTS, and NCUA requesting information about these agencies' processes for assessing the lenders under their authority that the Federal Reserve had flagged as having demonstrated significantly significant disparities for compliance with fair housing laws.

Let me just be clear, having given that framework. Ladies and gentlemen, this issue is not going to go away. Discrimination in lending has to stop. It has to stop for several reasons. Number one, because it is against the law. Number two, you can't look at us and say get equal education, get equal loan scores, credit scores, get equal in every aspect of your life, and then at the end of the day, make statistically disparate impact loans that are explainable only in racial terms. You factor out everything else. This has to stop.

It has to stop because more than 70 percent of the assets in the African American community are tied up in residences, in equity in homes, and if we don't have that, we don't have anything. You can't point to stocks and bonds and mutual funds and retirement accounts; our equity is in our homes, and that is the only source of wealth in our communities.

This has to stop, and we will continue to pursue it until it does stop. You can't look at us and say well, it is a burden to keep HMDA data when the data suggests that discrimination is continuing. You get your house in order on that front, then you can talk to us about stopping the burdensome aspects of these regulations.

So there is a quid pro quo here. It has to stop. One-tenth of a point, a quarter point, a half a point means thousands and thousands of dollars over the life of a loan. And these disparities have to stop.

I am talking to everybody in the audience, Mr. Chairman. They know who I am talking to. We have to stop this practice.

Mr. Chairman, I would ask unanimous consent that since they are not represented here today, although they are represented indirectly, I suppose through other people, that the statements of Acorn, NCRC, and the National Training and Information Center, all be submitted for the record, and that we submit the statements that we have gotten so far in response from HUD, DOJ, OCC, FDIC, OTS, and NCUA because we will be pursuing those inquiries until this stops.

I yield back.

Chairman BACHUS. Without objection, and hearing none, those statements will be in the record and become part of the hearing record. Ranking Member Frank, would you like to train for the chairman's job?

Mr. FRANK. Yes, I would.

I want to begin by expressing the strongest possible support for what my colleague from North Carolina has just said. I am very proud of the good working relationships that we on the Democratic side have had with our friends in the financial services industry. We have had good relations with the regulators, but I am very disappointed with the response that we have seen to this HMDA data.

I do recall, since I was here at the time, that the legislation that resulted in this data being made available was adopted over the strong objections of many in the industry. Our former colleague, Joe Kennedy, took the lead. Tough vote. It was actually defeated in this committee and then won on the Floor.

We have a record that shows that African Americans and Hispanic people are less likely to get loans and will have to pay more for the loans that they do get. All I read from the regulators, frankly, and the financial services industry is well, there are good reasons for it. It is not racism; it can be explained here.

I understand that there are qualifications and explanations that ought to be introduced in reacting to the data. The problem is what I read gives us the explanations without the reactions.

I would have hoped that people would have said that this is a very bad situation, and we have to change it, as my friend from North Carolina said. Instead, the overwhelming tone that is it is not my fault, and that there is nothing you can do about it, and that none of my institutions are doing it.

Race continues to be the most serious problem in America. We have just gotten an indication here that when it comes to a basic tenet of American capitalism, there is nothing remotely radical about this, when it comes to a basic tenet of American capitalism, there is significant discrimination, in fact, according to racial and ethnic lines.

Now I don't believe that it is all racism, and I don't believe that none of it is. Anybody who tells me in America today, with our history, that racism and racial prejudice isn't a part of it is kidding herself, but not me. That just can't be the case.

But I also acknowledge that there are factors other than simple racism or even sophisticated racism. But having denied that it is racism doesn't mean that we don't have a problem. Much of what I see here says look, it is not just racism, there are all these other problems. If there are, let's talk about how to solve them. Let's talk about what we do.

It is unacceptable, frankly, the tone of the responses and testimony we have here. This kind of collective, "Well, that is the way the world works," isn't acceptable. I will continue to work closely with people on the Financial Services Committee. I think the function that banks and lenders play is a critical one, but we cannot continue to ignore this racially disparate impact, and people need to do a much better job than they have in the testimony I have seen, even from the regulators. So this one is not going away.

Now most of the regulators, we are told, are still studying this, because the Federal Reserve itself said that in some cases it would appear to be race. Most of the regulators say that they are still working on it. I would like to see what is happening. This has been out for a while now. We are not going to be out-waited on this. We will continue to return to this.

So I really strongly urge my friends in the industry, please, take this more seriously as a problem that has to be alleviated than you have. We cannot continue in this country to pretend that race is not still a problem in many ways. When African Americans are significantly worse off when it comes to getting a loan to buy a home, we need to figure out exactly why that is and then try to deal with it. Simply saying, "Well, it is not a racial problem, and that is the end of it," is, one, I think somewhat inaccurate, but, two, totally unacceptable.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Frank.

Mr. McHenry.

Mr. MCHENRY. Thank you, Mr. Chairman. I certainly appreciate you holding this hearing and look forward to the testimony from our wonderful panel we have coming before us, two separate panels. The Home Mortgage Disclosure Act information that we are going to be discussing today is a very important finding by the Federal Reserve, and it is important that we, as a committee, consider all the factors related to the cost of a mortgage on individual borrowers—their credit rating, net worth, their personal debts, and the whole variety of issues that are associated with it.

For a first-time home buyer, it is a daunting task to get lending. I think it is important for us to have a fair and balanced way of disclosure to individual borrowers but beyond that, to make sure that the lending industry is competitive, that free market principles reign, and that as a result of that, individual borrowers will benefit.

The individuality of the borrower demands a wide array of choices in the mortgage lending marketplace. For the home mortgage lending market to evolve further, it must be free of over burdensome regulation.

In the early 1990's, subprime mortgage lenders emerged because market demand was not being met by prime mortgage lenders. According to a study by a former member of the Federal Reserve

Board of Governors, from 1994 to 2003, subprime lending went from $45 billion a year to over $330 billion a year, now making up one in 10 mortgages. In that period, almost 9 million Americans, more than half minorities, became first time home buyers, pushing the homeownership rate to an all time high of 69 percent across America.

I think that is something we should be proud of as policymakers and something we should be proud of as Americans. It is clear that subprime lending has increased credit to individuals who previously hadn't been afforded the opportunity, given their credit rating, savings, or personal income.

I look forward to the testimony from this panel and the questions from fellow committee members about the HMDA data and, as we review the findings, it is important that we acknowledge that the nonprime lending marketplace has given countless underserved Americans access to the dream of homeownership. As public policymakers, we have to be sure this is done free of discrimination in any way, shape, or form, and that it is justified based on all the factors that the borrower brings forward to the lender, including their credit rating, their personal wealth, their personal ownership of assets and their personal debt, and to ensure that the future competitiveness of loans, we must allow the open competitive market to thrive.

As policymakers, I think it should be our intent to make sure that the free market system works, especially when it comes to homeownership. We want to make sure that first time home buyers are able to access the resources that they need to actually purchase a home.

Thank you, Mr. Chairman, for hosting this hearing and I look forward to the testimony.

Chairman BACHUS. Thank you.

The gentleman from New York is recognized.

Mr. MEEKS. Thank you, Mr. Chairman.

I think what we just heard is part of what the problem is because this is not really a hearing on what the disinformation of what the HMDA data shows, not talking about subprime lending versus prime lending, it is not talking about the homeownership. African Americans definitely, like anyone else, want to own a home. They get it and they understand generally that it is the best and most important investment they can make in their lives and indeed as Mr. Watt indicated, it is their biggest investment. Probably one of the largest investments that most people, not only African Americans, but most people make in their lives would be in their home.

And we preach and teach talking about the fact that we want them to buy a home because it is an appreciating asset, as opposed to a car. However, there still should be some equity in getting a loan. So if you happen to go to a subprime and you don't belong in a subprime, you should be told to go to a prime and/or if you are two individuals that have the exact same credit scores, have the exact same income, have the exact same background, and the only difference is the color of your skin, and so therefore, you pay more money than the other, there is something wrong with that and that cannot be tolerated.

And this regulation with reference to HMDA, whatever it is that say that is burdensome, well, until it is burdensome on a whole group of people who have to pay thousands of extra dollars over the course of the mortgage simply based upon the color of their skin, it must change, as Mr. Watt said. It is not acceptable.

You want to relieve the burden of having to go through the paperwork with reference to HMDA data? The best way to relieve the burden is to change and fix the problem so that individuals who have the same scores can get the same rate, and it is not, as reflected in here, based upon the color of your skin.

Now I know some argue that maybe it is a financial literacy piece. Well, if that is what you are saying, then I would urge you to get more involved in educating individuals in regard to financial literacy. That helps relieve the burden. Then if we can show that we have things on a level playing field now, then we can talk about something else.

But until we can show that the playing field is level for everybody, the burdens in the requirements of supplying the HMDA data, I know, for my part, will never, ever change. It is something that must happen, and simply to say I don't know how it happened, or I don't know why the data is what it is, is not acceptable.

So those who may be in institutions who say look at our individual data, I would say, look at and talk to the others in the same association as you are, and say we are in this thing together and we have to figure out a fix if you don't want collectively to have the requirements of coming up with HMDA data.

So this has to stop. This is, after all, 2006, and we would like to think that we have made, and we have made a lot of progress, but obviously, from the data that we have seen here, a lot has changed but there are a lot of other things that have not changed, have yet to change, and we have to be sure that it does begin to, otherwise we have to continue to stress this, and I think there will be other consequences down the road.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Meeks.

Mr. Baca.

Mr. BACA. Thank you very much for having this hearing today, and I also want to thank Representative Mel Watt.

Last week, I attended a hearing along with Representative Clay and others to discuss concerns regarding mortgage discriminations finding in a new report released by the Center for Responsible Lending.

The report indicates that after controlling for risk factors, minorities were more than 30 percent likely to receive a higher rate than White borrowers. We have to ask ourselves why there is a disparity. That is a question we have to ask ourselves. The report has come out. Why is there a disparity?

It appears that the Federal Reserve found that Latinos are 2.3 times more likely to receive higher cost loans than Whites. Why? We have to ask ourselves why. Blacks are 3.7 times more likely. Why? Is there a disparity in how those loans are distributed?

These price disparities should concern everyone in this room because basically, what we all want, Black, White, Indian, American

Indian, all of us, all we want is respect, equal treatment, and equality.

We don't want to go back to say that there are violations of civil rights or discrimination. But we have to stop this disparity that exists today. The data shows that minorities are not getting equal treatment and are deliberately being steered into high cost subprime loans. Why? Because they are vulnerable, and don't have the education, they are easy prey. We have the marketers that are out there.

It is like all of us, capital gives us asset. I know because I remember the very first time that my parents bought a home—we came from a large family of 15—having that home and having roots. But you also know that you have to provide for a family and so someone is preying and someone calls them and they say all right, here is an easy fix. You need a loan, you need capital, you have a mortgage, you have payments, you have other responsibilities, here is an opportunity to prey into a high subprime loan, an adjustable loan or whatever the case may be.

These loans should be the last resort for all of us. While subprime loans have helped many families get into their first home, they are risky and high-priced and have foreclosure rates twice that of prime loans.

Too many mortgage loans and brokers are taking advantage of the low income minority borrowers by placing them in high-risk mortgages which they cannot afford, and they know they can't afford them, but they put them right into it. It is like the old way that we used to have when this country was first founded, many of us minorities owned land, we didn't have stakes, and the White man came and all of a sudden developed new laws and said these are the laws in place right now so if you don't have papers we are taking over.

It is just a different form right now. It being done. Some of the brokers are taking back their homes when individuals can't afford these homes. We are seeing many minority families being steered into nontraditional loans such as adjustable rate mortgages and interest only loans that carry risky terms, and that is what I was describing in terms of land claimers that we used to have. Well, it is a different form of land claimer that we have now.

As interest rates are rising, their monthly payments are becoming too high and becoming vulnerable for foreclosure. We see the cost of living going up but the adjustable costs in terms of wages are not increasing. Many individuals can't afford a home.

We have the largest growth, both minorities and others moving from L.A., Orange County, who are buying homes, and then all of a sudden, they are getting into these adjustable loans or high-risk loans that they are giving them and then they are foreclosing.

Some reports indicate that as many as 1.2 million families may lose their homes to foreclose this year. That is frightening when someone is going to lose their roots, their homes that they have established. 1.2 million families may lose their homes this year, nearly 3 times the amount in 2005.

These new products may be appropriate for some families, but for others the abuse has become a very serious problem. Hispanic families rely heavily on mortgage brokers, that is why it is impor-

tant to have education literacy both in Spanish and English in the centers.

The industry lacks the accountability to consumers and too many Latino families are falling through the cracks. Bad actors must be held accountable, and I say bad actors, and there are good actors out there. I want to state that, too, for the record. There are good actors, but there are a lot of bad actors as well. There should be a list of those bad actors to ensure that home buyers have equal access to fairly priced homes.

I look forward to continuing to work with this committee and to look at developing legislation to address this issue. As Representative Mel Watt indicated, we have to stop this type of discrimination. All we want is equal respect, and equality for all of us.

Thank you.

Chairman BACHUS. Thank you, Mr. Baca.

Mr. Neugebauer.

Mr. NEUGEBAUER. Mr. Chairman, I yield my time to the distinguished chairman.

Chairman BACHUS. I thank you.

Governor Olson, you have heard several opening statements, and normally we have limited them to 5 minutes but some have been longer than that. I think the reason for that is the importance of this subject.

You are going to hear more opening statements before we start, because members feel very strongly about this issue. I think if there is anything that a member serving on the Financial Services Committee comes to realize, it is the value of homeownership. It is really economically and socially the pathway to wealth accumulation, to a store of wealth. It is a source of stability, not only for families, but also communities. You can look at a community, look at the percentage of homeownership, and you can—that is a predictor of crime rates, educational progress, and advancement.

I said in my opening statement that homeownership is part of the American dream. It is the greatest investment that most families make, so it is absolutely important that we ensure and that we take steps to stop discrimination in mortgage lending. There will always be different treatment because there are different incomes, and different documentation on loans. There are always reasons for people to get different interest rates and to be charged different fees, but one of the reasons can never be racially motivated.

We talk about fair play, Mr. Meeks talked about a level playing field. It is absolutely essential to our democracy if it is to function well and accord equal opportunity that we do not have racial discrimination in our mortgage lending. So this is, in fact, a very important hearing.

I can't understate the effects that discrimination, the consequences of discrimination in mortgage lending. If there is significant racial discrimination, then it is of great significance and importance to all of us.

With that said, our next speaker—I would like to ask unanimous consent that the gentleman from Alabama, Mr. Davis, who is not on this subcommittee, be allowed to make an opening statement. Hearing no objection, Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman, for welcoming me back to the subcommittee and giving me leave to make an opening statement and to ask questions.

Mr. Baca asked the question, and a number of people have asked the question, of why these disparities exist and why they go on, and I agree with my good friend from New York, Mr. Meeks, and I agree with my friend from Massachusetts, Mr. Frank, that it is not just enough to throw up our hands and say, "Oh, these things happen, but I didn't do it." It is off in the air somewhere.

Let me take a stab at why I think part of this happens. What the mortgage industry does is fundamentally and qualitatively different from what the legal profession does and from what the medical profession does. I will tell you what I mean when I say that.

I am a lawyer. I have had that license for 13 years now. When I was practicing law and a client came to see me I had an obligation to give that client the best representation I could provide. I didn't get to say if you pay me "X" amount of money, I will give you this amount of representation, but if you pay me "X" amount of money, I will give you this amount of representation. Once you sign the contract, you better give that person the best of your intelligence about his or her case.

Those of us who have been to see doctors, we understand that once you walk in and the doctor takes on that case, you don't get certain treatment based on whether you are a Medicare patient or Medicaid patient. You get the best treatment that can be provided by that doctor.

I would submit that is not the case when it comes to someone who is engaging in a mortgage transaction. You don't get the best service you can possibly get, you get the service that is in the interest of the broker, you get the service that is in the interest of the bank making the loan.

And think of what that would mean if a lawyer, Mr. Olson, provided advice to clients based on what was in his or her best interest financially. Think of what it would mean if the doctor said I will encourage you to do whatever would get my Medicare billing rates to the highest level. We call that fraud.

That is the root of the problem, in my opinion. There has to be an ethic in this industry that is frankly as good as what doctors and lawyers give out. We are not the most noble people in the world and we still manage it.

There has to be an ethic that says that when you come in here for a transaction, we are going to give you the best information we can and the best advice that we can. We owe that to you as part of our fiduciary relationship. That ought to be the written ethic in the profession, that ought to be something that we try to see if we can write into law, but more than writing in law, it has to be written into practice.

Then I want to make this other point. What is amazing to me, I remember when had a hearing in this very room, Mr. Olson, and there was testimony from, I think, someone who was president of the Mortgage Bankers or one of the groups and I asked the question, do we think that this disparity in subprime lending, do we think it is based purely on market-based factors, and the chairman

of the Mortgage Bankers said no, it is not. Then other people from the industry and other various lobbyists said no, it is not.

Can you imagine, Mr. Chairman, if the Speaker of the House were to make a statement tomorrow that yes, some hiring in the House of Representatives is based on race, or if the Chairman of the Joint Chiefs were to say some promotions in the military are based on race, I think we would worry about that.

We haven't had that kind of outcry over those kinds of concessions from the industry, and it ought to move us. We have a large number of people here today, and that is great to have that many people, but I am reminded as I conclude today that when Senator Robert Kennedy was being laid to rest, Larry O'Brien, who became NBA Commissioner, has been Postmaster General, run Bobby Kennedy's political operation, and he made the comment what wonderful crowds. And then someone on the train said yes, but what are they good for.

I close by saying, I see all these people from all sectors of this argument who are here today and a higher than average number of members here, but what good is it if we don't get as worried and concerned about the industry coming into this room and admitting part of the problem is race and not coming forward with steps to deal with it, solutions.

This has to move us to action. If it doesn't, those of you in the industry, I make this point to you, and I make it as a friendly statement, the distrust you breed will cost you money. The distrust you breed will cost you customers.

So we all have a stake in more transparency and accountability here, and this ought to be the beginning of a process and it ought to produce results before we leave here for recess in August.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Davis.

Ms. Lee. Ms. Lee was one of the members who actually requested this hearing. We welcome your opening statement.

Ms. LEE. Thank you, Mr. Chairman, I will try to be very brief, but I want to thank you and our ranking member for this hearing, and also just associate myself with probably all of the remarks that have been made already, but add to that that it is very clear to me that the American dream is becoming a nightmare for so many Americans and in California, for example, and I need to ask this question in advance of the testimony, because I had been working with Mr. Greenspan on the CRA ratings.

For example, the financial institutions, the majority of them in California, the majority receive outstanding "A" grading scores as it relates to CRA ratings, when I looked at the mortgage lending data as it relates to African Americans and Latinos, they were, like, between 1 and 4 percent of mortgage lending.

For the life of me, I never could, and Mr. Greenspan could never explain why an institution could get an outstanding rating, and yet be so dismal in their mortgage lending to African Americans and Latinos. So I hope that will be addressed at some point in this hearing.

Finally, let me just say, oftentimes, we are accused of playing the race card. Well, I think this data, this information really is an example though of when some of us talk about institutional racism,

how it has been institutionalized and how, of course, people of color, communities of color end up on the losing end.

I think when you look at the subprime lending, and I am looking at Mr. Olson's—a couple of statements that you made on page 9 of your testimony, indicating that some of the segmentation of the market by race and ethnicity may reflect objective differences in borrowers' preferences or differences from credit risk indicators. I think the majority of borrowers in our country, regardless of their race or ethnicity, want to be treated fairly; do not want to be victim to predatory lending; want to know what they are getting into; and want to make sure that their loans are going to be loans that allow them to realize the American dream in terms of acquiring the equity that they need or they want, or that they deserve so they can send their kids to college, start a small business or whatever. But when we have such a large percentage of minorities in the subprime market, it begs the question in terms of just the advances we have made in racial discrimination and institutional racism in our country.

So thank you, Mr. Chairman, for this hearing. I look forward to the testimony.

Chairman BACHUS. I thank the gentlelady from California.

The gentleman from Missouri, Mr. Clay, I recognize you for your opening statement.

Mr. CLAY. The statement is very brief. Good morning to all and thank you for holding this hearing, Mr. Chairman. The Home Mortgage Disclosure Act is an important tool for my district and for most districts that are in metropolitan areas. The data reported under HMDA includes information about denied home loan application, race, sex, and income of the borrower. Additionally, lenders have to report all first mortgages priced 3 percentage points above Treasury yield and all secondary mortgages 5 percentage points over Treasury yield.

We need this tool in my district to combat predatory lending, discrimination in lending, and many other ills associated with obtaining affordable housing. I was disturbed when proposals were made to eliminate the requirement that intermediate small banks collect and disseminate CRA data on small business, small firms, and community development lending.

The elimination of this data will eliminate the ability by which communities themselves measure whether the bank is meeting the small business needs of the community. There are no adequate substitutes for this data. I understand that financial institutions have concerns about the cost and efforts required to produce and disseminate the data, however, the value of the data to our districts far outweigh the cost associated with this collection.

I am eager to hear what our panelists have to say on this issue, and I yield back the balance of my time, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Clay.

That concludes the opening statements from the committee members and at this time, we will recognize the Honorable Mark Olson, Board of Governors, Federal Reserve System. Governor Olson, welcome to the committee.

STATEMENT OF HON. MARK W. OLSON, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. OLSON. Thank you very much, Chairman Bachus, and members of the committee. I have an opening statement, which I would ask to be submitted for the record but, Mr. Chairman, you and others have hit the highlights of what I have to say regarding the intent of HMDA, the concern about racial discrimination, and the evolution, if you will, of some of HMDA, so I will just make a couple of points that were brought up in the questions.

In your opening statement, you talked about the importance of eliminating racial discrimination. What I heard from so many of the members was the degree of frustration that we are finding because of the persistence that we find in the studies. It is a concern that we share.

Congressman Watt, in your testimony or your discussion, you identified the laws, such as the Fair Housing Act, that really are the core of fair lending, and I would remind the committee that those laws have been on the books in some cases for 40 years, and in some cases for 30 years. We have been asking banks to be in compliance with those laws for all those periods of time.

When the HMDA information was first disclosed, and Congressman Frank pointed out, initially it was by an amendment to allow for that information to be made public. If we would have had the discussion 15 years ago, not quite 15, 13 years ago after the first reports had come out, I suspect that your concern would have been about the approval-denial ratio because that was our understanding of the racial component in lending a number of years ago.

The dynamic changes that have taken place in the mortgage market over that period of time have shifted our concern. We still are concerned about approval-denial. But to a greater extent, we are focused on the difference in pricing and to the extent that those difference in prices are, in fact, race-based, and that is, of course, disparate treatment and is the violation of fair lending standards. We continue to examine institutions for that purpose.

Now we are in the process of also holding hearings around the country on the HOEPA legislation which is also focusing in a significant way on the changes that we are seeing in the marketplace. Several of you have alluded to the fact that in the marketplace there is a tremendous amount of marketing activity and a certain amount, perhaps, of steering activity that is going on and the great concern is that equally situated borrowers are not receiving equal treatment, which is the essence of fair lending.

When we, as the Federal Reserve, look at the HMDA data, that is not our first look at the lending activity of these institutions. We examine all of these institutions on a routine basis. In some of those institutions, we are physically in the institution continuously, and have an opportunity to continuously evaluate their compliance with fair lending laws.

Let me move forward to 2004. It was an initiation of the Federal Reserve that we asked for pricing data, that is the pricing data to be publicly released because the pricing data is the point now where we are most likely to find the opportunities for disparate treatment. But that is not the first look that we, the Federal Reserve or the other regulators, have had with respect to that issue.

We have been aware of that shift in the marketplace or that growing change in the marketplace. As Congressman McHenry suggested, the subprime markets has grown rapidly over the last number of years, and the good part of that is there is enormous societal value in providing additional mortgage activity to a wider range of borrowers. The downside of that is that there are more opportunities for mischief.

So when we go in and look at an institution and we have been examining for those factors for many years, we start by looking at the extent to which their policies and procedures and their risk management tools examine for possible disparate treatment or fair lending compliance. We then look at, for example, the manner in which they monitor those who are buying loans on behalf of the institution from brokers, the extent to which they are evaluating these brokers, we look at the extent to which individual borrowers with individual characteristics are given the same treatment.

We have had a chance to look at the initial HMDA data in the aggregate, and we are in the process of now looking at it on an institution-by-institution basis.

Of the 200 institutions, as we have pointed out, that were identified where there was some statistical disparity, somewhere between 30 and 40, perhaps 35 of them are Federal Reserve regulated institutions. In each of those instances, we have initiated discussions, and in some cases, have been deep into looking at and evaluating the extent to which that additional information gives us a different prism to look at the manner in which they are in compliance.

Mr. Chairman, we support the efforts of this committee, we support certainly the efforts of Congress to address this important subject, and I would be happy to answer any questions.

[The prepared statement of Governor Olson can be found on page 66 of the appendix.]

Chairman BACHUS. Governor Olson, I very much appreciate your testimony. I thought it was very to the point and valuable to our committee as we explore this.

Let me ask you this, the Congress is presently considering the Voting Rights Act. The 15th amendment was passed in 1870, giving all of our citizens the right to vote, at least all except women, who obtained that right later. But it wasn't until the Voting Rights Act that really most of our citizens, they had the constitutional right to vote, many of them were denied that right, many votes weren't counted until we had a Voting Rights Act some hundred years later.

We have all sorts of laws on the books which prohibit racial discrimination in lending practices, and yet, in your knowledge at least, there is an appearance that discrimination may go on. Is there something else we need? I mean, do we need further legislation; do we need to gather more data?

I said in my opening statement that at least with high cost loans, since 2002, when the Federal Reserve started, I think it was gathered in 2004 under HMDA the lenders had to first disclose. But are there other things that we—do we need to gather other information, do we need to gather what the borrowers' asset level was and their credit scores, the loan-to-bank ratio of the property, the bor-

rowers' debt to income ratio or the level of documentation submitted. Is there something else we need to do, or the Federal Reserve needs to do?

Mr. OLSON. Let me separate the issue, because there are two components to it.

The pricing data is not difficult for the regulators to get at the pricing data, because we go in and examine an institution's entire portfolio, and examiners, all of the bank examiners from all agencies and all of the examiners of mortgage lenders, have had the ability to look at that data and examine that data very carefully. We have always had that ability. Only recently, though, has that been included, as you pointed out, in the public release of HMDA data.

Now that helps identify another issue that perhaps—but not fully—HMDA data alone does not give you a complete picture of the extent to which there might be discrimination in the lending process.

Incrementally, if you were to add to that, it probably would not also lead you to that final fundamental determination of discrimination because discrimination now is usually not overt, to the extent that it exists and it clearly does still exist, it is very subtle. So you have to look very carefully at all the data that you have available.

Also across institutions it is very difficult to make comparisons. For example, if you were to add a credit score, different organizations use different kinds of scores and, increasingly, especially the largest institutions are now building their own scoring models. So if you were to compare across institutions, it is very difficult to make that determination.

I would say, however, that we are in the process now in the hearings that are going on, the HOEPA hearings—we have had two. We have two more scheduled, one at the end of this week, and one later on. We are discovering a great deal more about the changing marketplace. Incidentally, the second panel that you have coming on next, many of those people have been part of the hearings that we have had. They have provided excellent additional information as to the changes that have taken places.

My suggestion would be, respectfully, that before Congress would consider additional legislation, we understand fully the extent to which we know the changes that are taking place in the market and how best to address them.

Chairman BACHUS. Thank you.

Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. Thank you, Mr. Olson.

Chairman BACHUS. Actually—I'm sorry. It should be Mr. Frank. I apologize.

Mr. FRANK. I thank the gentleman, because we do have the HUD Transportation Appropriations, so I am going to have to leave.

Mr. Olson, you say we should not legislate until we get all that done. When do you expect we will have it?

Mr. OLSON. Well, there are no destinations, there are only journeys.

Mr. FRANK. Then that is the problem.

Mr. OLSON. Our hearings will be complete by July. We will have a chance to look at this initial round of disclosures. This will be ongoing.

Mr. FRANK. But if it is ongoing—excuse me. No, I'm sorry—do not legislate until we have the information. But if there is no destination, it is ongoing, and we will never get there. You heard this from my colleagues. There is a crisis here. We do very well in a lot of areas, but there is a crisis. You have significant numbers of Americans who think they are getting frozen out of the system. So we cannot wait that long.

I will be honest with you. I do not see, on the part of the financial services industry or the regulators, the kind of urgency that many of us think that this situation requires. If the HMDA data alone isn't enough, then tell me what we need to do to expand the data and collect it and analyze it. The Federal Reserve is very good at all kinds of very sophisticated analysis. Too much of this testimony is, we do not have enough, we need more. This is an urgent issue. We can have—

Go ahead.

Mr. OLSON. No, go ahead.

Mr. FRANK. I do have to address—several of us talked about it. I was struck by it. I know Ms. Lee mentioned it. On page 9, you say, "Black and Hispanic borrowers are more likely to obtain mortgage loans from institutions that tend to specialize in subprime lending. Now, at least part of this segmentation by race and ethnicity may reflect objective differences in borrowers' preferences."

Would you tell me what it is of the psyche of Black and Hispanic people that they would prefer to go to a subprime lender rather than someone else? I know you say there are other factors, but what are the factors?

Mr. OLSON. I suspect it reflects what we see in the marketplace now, which is push marketing.

Mr. FRANK. Excuse me. You do talk about—you say steering, etc. There are other factors. You did not say this is the only factor; I acknowledge that. But you said part of it is that the Blacks and Hispanics prefer to go to subprime lenders. Do you really want to stick with that? I mean, you did say it may go from being steered and there are different levels of literacy, but you said a preference for subprime lenders. What kind of people would prefer a subprime lender to a prime lender?

Mr. OLSON. It may not have been as artfully worded as it might have been, but the point that we are making is what we do see is that there do seem to be a larger number of African Americans in that community going to the subprime lenders.

Mr. FRANK. I understand that. That is not the problem. Do not blame the victim. That is exactly the problem. I know, let's go to the subprime lender. To impute that as a preference to the victims, frankly, makes people—the insensitivity sign goes up. Please, do not say that again.

Mr. OLSON. If I were wearing my sociological hat, I probably would have worded it differently. I apologize. But what we are doing is we are reflecting and describing the preferences that are demonstrated not simply because they like them better but the preferences that are demonstrated by the number of applications.

Mr. FRANK. But there are many reasons why, if you are an African American, you would wind up there. Why dig up their own preferences?

Mr. OLSON. That is a better way to say it.

Mr. FRANK. But, to be honest, that is what makes people nervous. This is victim blaming and stereotyping, to be honest. I know you do not believe this, but the fact that this gets into the testimony—you know, you guys are pretty good at vetting over there. When this slips through, that is what makes us nervous.

Let me say finally this—yes, help us with the data, but I do want to say to yourself and to all the other regulators, we have data that shows significant disparities. We have the Feds saying that while there are non-subjectively racist reasons for many—not most—of the disparities, there is some prima facie reason to believe that there is racism.

We live in America, where racism has been the curse of this country, and while we are making progress we have not totally eradicated it. If at the end of the analysis of this factual data which shows a substantial disparity nobody is penalized for engaging in racially discriminatory behavior, then the loss of confidence on the part of many of us is going to be overpowering.

Mr. OLSON. Congressman, we did not expand the data collection to pricing data to cover up the issue or to any way diminish the issue. We expanded the collection of data and the public distribution, or the public release of that information in order to shed greater light because we agree with you.

Now we knew that that would invite analysis, and we knew that it would perhaps invite criticism. Now even your discussion that you just gave, you were giving the data in the aggregate. You did not go—as did our initial report, which discussed the differences when you get down to an institution-by-institution basis which significantly eliminates or accounts—

Mr. FRANK. I appreciate that, and I acknowledge that many of the disparities can be explained in other ways. But by the Federal Reserve's own analysis of a number of institutions, it is hard to think of an explanation other than race. And I am saying this: If after we get this, in the end of the process, nobody found anybody guilty of anything, I am going to be very skeptical.

Mr. OLSON. So will I, frankly. And I think as we have a number of groups, we have a number of interested parties all looking at the same data. We have the lenders. We have the regulators. We have a number of community groups. Independently, we have some law enforcement agencies. I would agree with your conclusion.

Mr. FRANK. Thank you.

Thank you for the courtesy, Mr. Chairman.

Chairman BACHUS. Mr. McHenry.

Mr. MCHENRY. Thank you, Mr. Chairman. I certainly appreciate it.

To the ranking Democrat's question, who would have a preference for a subprime loan in the marketplace, there are no-doc loans—no-documentation loans that you can get quickly. And being involved in real estate investment, it is a good tool to have so you can close quickly on a property and not have to get a stack of paperwork to get the loan. Now you will be charged a higher rate and

additional fees to get it, but it is a wonderful thing to access that capital so you can purchase a property for investment purpose, and that is something that I have seen utilized a number of times.

But, thank you, Mr. Olson, for being here today. You said in your testimony that certainly the HMDA data, as it is presented, the HMDA data tells a great deal about lending patterns, but they do not tell the entire story. What would you have say could be the rest of the story?

Mr. OLSON. Well, there are a number of factors. The HMDA data—the publicly released HMDA data tells part of the story. If you are looking at all of the factors that go into the mortgage decision, either the approval or the pricing, you take into consideration a number of factors.

You just hit on a major one, which is the choice of products. There is a wider range on the choice of products depending whether somebody wants a low-doc or a no-doc or, for example, if the product is what we have always called a conforming product, which I am sure you are aware of which is a Fannie Mae- and Freddie Mac-approved product. Each of those contain different levels of documentation, different levels of cost, and, therefore, there are different levels of pricing involved. Also, the credit risks or the loan-to-value ratio of an institution. Those are some of the notable characteristics impacting pricing.

However, the people who are involved in fair lending or in the fair lending area tell me you need to look at roughly 30 different data points in order to really determine if there is, in fact, a disparity in treatment among borrowers.

Mr. MCHENRY. How many data points have you collected in this HMDA data?

Mr. OLSON. I think eight or nine. It is a relatively small number, and they are not necessarily the key ones. But the key ones are very sensitive—there are some privacy implications for having any of those data released to the public.

Mr. MCHENRY. But perhaps you have 25 percent of the data, maybe, for us to get a fair read on.

Mr. OLSON. Yes, but that is done on a weighted basis. But, yes, roughly.

Mr. MCHENRY. So it would be perhaps unfair for us to jump to conclusions or to draw significant conclusions from the HMDA data?

Mr. OLSON. HMDA data are very valuable, but, as we have stated, they are not definitive.

Mr. MCHENRY. So what would be one of the definitive ways to determine whether there is discrimination? Would it be the credit risk associated in matching that with sex, age, or race?

Mr. OLSON. As you look at an institution—as you look at an institution and within that institution, if you look within the institution either at the various channels or at the product mix, the question would be are equally situated borrowers treated equally? What we have described and some of what we have done, even with HMDA data, is to develop a systematic method of comparing borrowers called matched pair analysis. They might take an African American borrower, for example, vis-a-vis a White borrower or an Hispanic borrower versus a White borrower and find borrowers

with identical characteristics and then determine the extent to which they are treated similarly.

You need to get down to that sort of a fine comparative evaluation before you can make a determination as to whether or not there is disparate treatment.

Mr. MCHENRY. As policymakers on this committee, what conclusions can we draw from the HMDA data as presented?

Mr. OLSON. It is fair to draw a conclusion that there are differences among the treatment of minority borrowers and White borrowers that need explanation and that we ought to continually look at trying to determine why those differences exist.

Mr. MCHENRY. Thank you.

Chairman BACHUS. Thank you, Mr. McHenry.

Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

Mr. Olson, let me start by thanking you for some stuff. We do not want to kill the messenger, and I think it is significant and something that the Federal Reserve is to be commended for, that you have expanded the information from just an approve-deny decision to pricing data, analysis, collecting information that allows us to analyze pricing data, not just a decision about whether somebody gets a loan or does not get a loan. Because if there is disparity in treatment, if there is discrimination—and I distinguish between those two—it is getting more sophisticated. We know that.

I applaud the distribution of the HMDA data privately to the other regulators so that they can get right to work on doing what their authority gives them the right to do as regulators.

So nothing we say here should ignore those two applauses that I am giving you. You say there are 30 data points or somewhere in that range for determining disparate treatment. I do not think you mean that disparate treatment, you have already found anything. There may be 30 data points for determining whether it is discrimination or whether there is discrimination, but I think we already have the gross information about disparate treatment. Am I wrong about that? I do not want to get into a semantic session here.

Mr. OLSON. You are on a very important point. And I think that in the evolution of our understanding of what constitutes discrimination. Early on in the process thought of discrimination as being overt discrimination. We lend to Whites. We do not lend to Blacks. That was what discrimination was described as years ago. I think over the course of a number of years, we have learned that discrimination can also include either disparate impact or disparate treatment—

Mr. WATT. Disparate impact.

Mr. OLSON. —and the differences are significant. Because disparate impact and disparate treatment, especially disparate treatment, takes into consideration a whole wide range of factors, and you cannot have evaluated the entire impact—the entire universe without looking at that impact.

Mr. WATT. But let me be clear, Mr. Olson—and I hope I am trying to be fair and clear here—that race is not one of those 30 data points.

Mr. OLSON. It absolutely is. Especially if you are using regression, for example, you control for all of the factors and you determine what is left that is unexplainable, and if race is one of the factors that is unexplainable, then you have a real problem. So indeed it is, if you are looking at it, because in the context that we were talking about of disparate treatment—

Mr. WATT. Maybe I should ask the question in a slightly different way. Surely race—if race is the only data point standing at the end of the day, you have eliminated all of the other data points as explanations, then we have a problem.

Mr. OLSON. Exactly. And where institutions have historically run into difficulty in the past—

Mr. WATT. I am going to run out of time here.

Mr. OLSON. I will not take your time. I would be happy to come back, if you would like, and we can talk about this.

Mr. WATT. I want to go beyond the HMDA data, which you said touches on eight or nine of those data points, and ask you if you have had an opportunity to review the report of the Center for Responsible Lending? Have you had that opportunity?

Mr. OLSON. I have looked at it briefly, yes.

Mr. WATT. How many more of those 30 data points did they pick up in their analysis?

Mr. OLSON. That I don't remember right off the top of my head.

Mr. WATT. But significantly more, wouldn't you say, than the eight or nine that the Federal Reserve picked up, isn't that right?

Mr. OLSON. Not that the Federal Reserve picked up, that is released in the HMDA data.

Mr. WATT. In the HMDA data that the Federal Reserve released, right.

Mr. OLSON. I believe you are correct.

Mr. WATT. So if there are up to 20 out of those 29 maybe and race—they factored out, for a certain population, credit scores and geographic factors and other factors that are data points, and race still is standing as a significant factor, or appears to be, I take it that is troubling to you.

Mr. OLSON. Congressman, I believe that I am correct and—I am not sure I am correct—they looked at aggregate data.

Mr. WATT. No, as I understand what they did was they took the actual data based on actual loans and got down to that level and analyzed those loans, that you analyzed on an aggregate basis, on a specific basis and still found that race was a factor.

Mr. OLSON. You hit on the real key fact. You need to look at it on an institution-by-institution basis. In the initial look that we did, even of the HMDA data, when you look at it on an institution-by-institution basis, that explains a lot of that differential but not all of it. There still is a persistent difference that remains. But as we look at institutions, as we go in and examine those institutions, we can examine them very carefully on all of those bases.

Mr. WATT. And you are going to do that under the 30 to 40 that is under the Fed's jurisdiction?

Mr. OLSON. We will continue to do it.

Mr. WATT. Okay, and other regulators will do it, you hope?

Mr. OLSON. They do, trust me. They do the examinations as well.

Mr. WATT. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Watt.

At this time, we are going to recess. There are votes on the Floor.

Governor Olson, there are other members who do want the opportunity to ask you questions.

Mr. OLSON. Then I will stay.

Chairman BACHUS. We appreciate it. I commend you for your testimony thus far.

The hearing is recessed subject to votes on the Floor of the House. At the end of the last vote in this series, we will reconvene here.

[Recess]

Chairman BACHUS. The Subcommittee on Financial Institutions and Consumer Credit will come to order.

At this time, Governor Olson, we are going to allow additional time for members to ask questions. At this time, I will recognize Mr. Pearce for any questions he may have.

Mr. PEARCE. Thank you, Mr. Chairman, and thank you, Mr. Olson.

I was a little surprised to see you walk away from your comments that some borrowers might prefer. We find examples of that every day. My mom bought a higher-priced car for her whole life. She chose a higher price because she was more comfortable at the dealership. People choose higher-priced TV's.

The truth is that many lenders, many subprime lenders hire people who will talk the language, that will make them feel more comfortable, compared to going in a bank and seeing the rigors there.

So I think you had it adequately stated, and I saw you lose your nerve. I do not really need a comment. I am just making an observation that I think, in truth, there are times when people have preferences even to the point of damage. People willingly purchase narcotics knowing that it is not the best thing for them. So I think there is an element of personal responsibility. I do not say that there are not problems and even deep problems.

How long have you been with the Federal Reserve, Mr. Olson?

Mr. OLSON. I have been a Governor for four-and-a-half years.

Mr. PEARCE. Four-and-a-half years. And how long have you been with the Reserve overall?

Mr. OLSON. That is my entire experience with the Fed. I have been in banking and the banking consulting business for 35 years.

Mr. PEARCE. Where I am headed is I see that on page 7 you conclude that the HMDA data lacks information and that you cannot use that to observe racial or ethic differences in the price of loans as being the result of unlawful discrimination. If you cannot determine that from HMDA loans, have you submitted a request for the measurement parameters that would allow you to ascertain that?

Just, yes, you have submitted the request or, no, you have not.

Mr. OLSON. The distinction—the point we are making is that you do not make that determination based on the information that is—

Mr. PEARCE. I understand that. Have you asked for the full and complete information that will allow you to get to the point that we have been discussing?

Mr. OLSON. We get the full and complete information when we go into the institution.

Mr. PEARCE. Your statement says HMDA does not allow you to arrive at the conclusion of whether or not it is unlawful discrimination. Is that not the statement on page 7?

Mr. OLSON. That is the statement.

Mr. PEARCE. Is that how you then asked for enough additional data that would allow you to ascertain that?

Mr. OLSON. I am trying to answer the question. The answer is we have all the access we need to that information, but it is not information that is in the public domain. HMDA data gives us one prism with which we look at that organization, but on a constant basis, on a consistent regular basis, we go into an institution; we look at their entire loan portfolio.

Mr. PEARCE. So the fact that it is not made available to the public domain does not stop you from regulating it, does it?

Mr. OLSON. That is correct.

Mr. PEARCE. How many instances of enforcement have you had in the last four-and-a-half years that you know of where you have actually gone in and given somebody a whack for discriminating racially?

Mr. OLSON. In terms of the referrals to the Justice Department, we have had 35 over the last decade. Now how many of those have been in the last four-and-a-half years I could not tell you.

Mr. PEARCE. Thirty-five in the last decade of approximately how many investigations? How many banks have you looked at in 10 years?

Mr. OLSON. Nine hundred banks that we regulate, so that we would have reason to examine on a frequent basis.

Mr. PEARCE. Now then when I listen to your testimony, not your written testimony but your spoken testimony, I hear that you share the concerns that we share, that there are laws on the books for 30 years, that the HMDA was an amendment that Mr. Meeks described, additional thousands paid by minorities. Yet if the solution is within your reach, if you have all the data you need to determine if people are discriminating and steering towards, I just do not understand why that—your presentation—your verbal presentation gave the appearance that you are kind of in concert with us, that you agreed with us but you are unable to do anything about it. But yet I feel through your discussion you have the capability to do something about it, and it is confusing.

I will let you answer that. I see my time has expired.

It is disorienting to hear you agreeing with all the testimony, which is fine, but then the role of the governors is regulatory and you have the capability to do something, but that is not in the tone and tenor that came across in your verbal presentation.

Thank you, Mr. Chairman.

Mr. OLSON. Then let me try once more.

Of the roughly 9,000 institutions that provide HMDA data—9,000 institutions have provided HMDA data after we have started asking for public disclosure of the pricing data. Of those 9,000, in roughly 200 we found statistical disparity, and this statistical disparity could be in one of two forms, either in the numbers of borrowers—the relative numbers of borrowers who have received high price loans or in the interest disparity on the APR. So that is 200 out of 9,000.

Of those 200, somewhere between 30 and 40 are institutions that we regulate. And of those 30 to 40, some of them may be multiple HMDA providers within the same organizations. Those are institutions that we have examined for many, many years for fair lending, and that we have required to disclose to us how they manage their fair lending responsibilities.

Now in addition to all of the examination procedures that we have done in the past, we then look at them again in light of the new HMDA data.

Now what I have not said yet but is important to say is that, of those 200, probably 100 of them, probably half of them, are mortgage lenders that are outside of the banking industry in terms of the regulatory oversight. They are national bank or bank holding companies or bank subsidiaries. And I suspect that a good deal of the instances of questionable behavior that we find are in those institutions because they do not receive regulation with the same rigor as do the banks or the bank subsidiaries.

Chairman BACHUS. Thank you, Mr. Pearce.

Mr. Meeks, do you have questions?

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Olson, let me first thank you for your testimony.

Let me make sure that I am clear, also, because I think it is important. I agree with you that maybe 20 years ago or less than that we were concerned, very definitely, about approval or denial, but I do not believe that we intended that to mean that individuals can be approved but get ripped off. At the same token, I want to be clear that I am not against subprime lending. I am against predatory lending, and I see that as two different things.

But what I am against is and what I think that I know some of the studies have shown, where both a minority individual and a nonminority can go to a subprime lender with the same credit scores. It shows that, basically everything else being equal, the nonminority would be given advice or direction or something of that nature to how they can get a cheaper rate. But the minority is just given the most expensive rate. That kind of disparity is what I am focused on and I think should not be happening.

And the same goes whether you are a subprime lender or prime lender. If you have the same background, everything being equal, you should have the same rights, and if there is a practice to steer one to a better rate, then both should be steered to a better rate.

Historically, because of what you talked about and because of the way the marketing is done, because Blacks for too long had been denied by prime banks and so, therefore, they got tired of being denied and denied and denied, and then there are advertisements that are projected to the minority community in particular saying that no credit, any credit, we always say yes, just come and get your mortgage, and individuals want to get a home because we have preached the value of home ownership and they want to be said yes to. And they are steered to the subprime lenders.

Once they got to the subprime lender, the guy looks and says they have A–1 credit, then the ethics, I think, that Mr. Davis was talking about should dictate that they should say, look, you do not need this. You can qualify for a better loan than this, and you should go someplace else.

We do not see that kind of policing, that kind of ethics, if you will, in the industry.

So I guess I led up to my question. One of my questions is this. Because then I also understand, as a result—and I do not know, maybe we need to increase the assessment area—that in those areas that have been classified as a CRA assessment area, in those areas we have found a much smaller disparity in lending rates then in those areas that have not been. So is it possible—because I am also trying to find out some solutions here. Is it a possible solution somehow that if we expand those assessment areas we can begin to again do something affirmatively to start eliminating the disparity that we see in these rates?

So that is my first question to you.

Mr. OLSON. The CRA philosophy is essentially that an institution that collects deposits in a certain area is required to meet the financial needs of that community as well. So that in every bank we essentially we ask them to define their CRA area footprint. In other words, the areas where they have branches, the area where they are in the deposit-gathering process, and then have them assess the needs of that community and then meet the financial needs of that community consistent with their financial product offerings.

Many of those institutions may have mortgage lending affiliates that have offices scattered throughout the country, and in those offices, they do not have the physical infrastructure, it is likely that in a lot of those institutions, the mortgage gathering process is done by mortgage brokers.

So one of the questions that we raised rhetorically in our evaluation is perhaps it is the additional use of mortgage brokers that has resulted in product differences that carry with them higher rates, and that is one of the issues that we want to look at. As we examine the banks and the bank holding companies, including their subsidiaries, that we regulate, that is one of the questions we ask them, what standards that they have in place to either police brokers or to provide the borrowers with a range of products that best fit their credit profile. So that is one of the criteria that we use.

Mr. MEEKS. I will just ask this real quickly, Mr. Chairman, because I go back and forth in my own mind.

One of the debates that we have here to combat steering and others is whether or not it would be better to have individual States address this behavior—we have strong anti-predatory lending statutes in New York, as opposed to having a national anti-predatory lending law—and whether or not that would help prevent this kind of steering. I just wondered whether you had an opinion on that.

Mr. OLSON. Congressman, we have not taken a position on that.

As I indicated earlier, we are in the process right now of going around the country and having hearings, what we call the HOEPA hearings. More broadly, we are looking at the changes that are taking place in the mortgage industry and in the mortgage market, and to the extent that there would be a legislative initiative that came from that, we would then look at it at that time. At the moment, we do not have a position on that bill.

Mr. MEEKS. Thank you.

Chairman BACHUS. Thank you, Mr. Meeks.

Mr. Baker.

Mr. BAKER. Thank you, Mr. Chairman. I appreciate your leadership on this issue and your bringing this matter to the attention of the committee.

I have several questions that I just want to try to get into the record, perhaps a slightly different understanding of the purpose and complexity of HMDA data.

Mr. Olson, my understanding is that HMDA data is a very broad brush regulatory tool that can open a window for the regulator to make further examination. But upon looking at the elements that are reported, I understand the data does not include, for example, the borrower's individual credit score, so that it would be difficult to know from HMDA data whether the person was a 550 or 750. I understand that HMDA data would not disclose, for example, at the time of closure whether it was a 100 percent loan or an 80 percent conforming loan. My opinion is there is a relevance between whether a person has significant equity in a home or whether they do not and the likelihood of not making their financial obligations.

It does not disclose, for example, whether there is cash-out at closing which falls into the range of those mystery objects, 125 percent of home equity loans. I am still trying to understand how we allow that to happen.

It does not disclose, for example, the borrower's debt-to-income ratio. So if the person were making $50,000 a year and had $200,000 in obligations in addition to a prospective $100,000 mortgage obligation, that might color the lending institutions about risk and rates.

It does not include, for example, the loan-to-value ratio. It does not include a consideration of the individual's other assets owned. For example, if they were invested in the markets, they had a relatively modest job but had $2- or $300,000 in a bank account somewhere, that might incent that lender to give a lower credit cost to the borrower because of a low-risk likelihood demonstrated by that person's past savings history.

It does not include an analysis of the person's employment record. They could be 20 years of age, right out of college, and employed 6 months. There is a high degree of risk associated with that person's earning capacity.

It does not include an analysis of the person's academic record, which in many cases leads to a determination of a person's future earnings capacity and stability of holding a job.

It does not include, for example, the variances in the lending institution's cost of funds, or a smaller institution in a rural market as competitive with a larger institution in an urban market might be at a market disadvantage in the cost of its own funding which then goes through to the ultimate borrower.

It does not include consideration that the three credit rating agencies, which all have their own proprietary method of rating me, for example, would be extraordinarily unlikely, almost impossible, for me to call the three rating agencies today and get all three of them to give me the same identical numerical score. I cannot believe all three national credit rating agencies are doing racial profiling. I think it has something to do with the proprietary meth-

odology with which they put in the financial indicators for that particular borrower.

Also, it does not take into consideration that if I go to lending institution "A" with the same credit score and the same profile and go to credit extender "B", that there might be two variant screens through which my credit application flows; and the same person going to two institutions will get a different credible evidence rating risk assessment with the same person—not similar, the same person. That is called competition. That is why when you go out and you are looking for a home loan you very rarely find 20 people all willing to extend the same credit on the same terms on the same day. There is variance because all of them have slightly different proprietary methodologies on how they come to these conclusions.

The reason why I bring these points up, it would appear to me to allege that there is racial profiling in the issuance of credit on the provision that HMDA data is the Bible and clear-cut philosophic statement on market activity, well, it seems to be a reach. I would hope that if a regulator, based on their discovery of the facts at a relevant institution, would find clear, convincing evidence that the same person who came in with the same score was treated differently from any other person with the same set of facts at the same institution for the same type of borrowing, we would find those people being treated equitably. And if they were not, wouldn't that be the regulator's responsibility to make further examination, call those executives in and say, let's get our business straight? Or am I wrong?

Mr. OLSON. I would go one step further. What you have described is a referral to the Justice Department. If you went through that entire analysis and found a pattern of discrimination, that is not what constitutes a referral to Justice. You said it exactly right. It is on an institution-by-institution basis. Because there are different risks. There are different risk appetites. There is a wider range of products. There is a wider range.

Mr. BAKER. I could apply at 10 o'clock in the morning, go back to the same institution at 2 o'clock and say, I've changed my mind; what's your rate now?

Mr. OLSON. The rate could have changed.

Mr. BAKER. And nothing has changed about me. It is all changed about the institution because their cost to funds is different.

So all of the variances that people make reference to need to be backed up by specific case representations that Mr. Jones went in and had the exact same profile as Mr. Smith. Mr. Jones was denied, and that becomes an actionable case by the Department of Justice.

Mr. OLSON. That is correct.

Mr. BAKER. Thank you, very much.

Chairman BACHUS. Thank you, Mr. Baker.

Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman, for not only holding this hearing and working with Mr. Watt and others to hold it, but thank you for redirecting me to the hearing when I was headed in another direction; I appreciate that.

I have been trying to learn more about the role of brokers and loan officers, and the initiation of loan packages by people who are associated either with financial institutions or with other brokers, etc. Would you explain to me—and perhaps I should know this—what kind of latitude does an institution have in paying those who initiate loans for them—the yield spread, the difference in what the institution requests and the interest rates charged to the homebuyer, or other kind of pricing and what the broker can ask for—how does this impact the consumer?

Mr. OLSON. The yield spread premium I think is what you are referring to.

Ms. WATERS. Yes, that is what it is.

Mr. OLSON. As far as I know, there are no legal parameters around what a yield spread premium would require, but there are disclosure requirements for the yield spread premium. In the regulated financial institutions, we require the lenders to purchase brokered mortgage products, to have parameters around what the yield spread premiums can be and what would be acceptable yield spread premiums. In the less regulated environment, I should say that same discipline may or may not happen.

Ms. WATERS. I need a little bit more explanation. You said that it is disclosed.

Mr. OLSON. Yes.

Ms. WATERS. And what have you learned about—that is okay, go ahead.

Mr. OLSON. This is a very important question.

Ms. WATERS. Yes.

Mr. OLSON. It is disclosed on the HUD one, HUD disclosure statement; there is some controversy about how consistently or how well it is disclosed.

Ms. WATERS. What do you know about it? Based on the disclosure or lack thereof, what can you tell us about how this is impacting the consumer? What percentage of the subprime mortgages have yield spread premiums? How much are they? What is the average rate? How does that add to the mortgage costs? What is it all about? And can one of these persons, who may or may not be trained or—I don't know what this relationship is. I see people on the street offering mortgages, and telling people all kind of things and trying to get them into all kinds of risky mortgages. What do you know about this?

Mr. OLSON. Congresswoman, let us get back to—I do not have at my disposal today a significant amount of informational analysis of the yield spread premium or the impact it has on the market, but we do have that information, and I would be happy to come back and provide that for you. Or, Mr. Chairman, I would be very happy to submit that for the record as well.

Chairman BACHUS. Thank you. Without objection.

Ms. WATERS. Yes, I suppose so.

But, Mr. Chairman, I would like for this issue to be the focus of our work as we look at the issue of predatory lending because I am finding that this yield spread premium is much larger than most of us understand. We need to know who gets to initiate these loans, not only much how much the spread is. I want to know what the various institutions are doing and how this works. So I would ap-

preciate him not just getting back to me but getting back to you and this committee.

Chairman BACHUS. Congresswoman Waters, as you know, in your discussions on predatory lending or subprime lending bill, we have discussed the yield spread premium, and it is part of our discussions going forward.

Ms. WATERS. Do you have any data that has been collected on it?

Chairman BACHUS. We do have data as to what different States and the Federal Government—the parameters they have set on yield spread premium and what different States—the approaches they have taken.

We probably are going to meet this Thursday, and I have been meeting with Mr. Frank, Mr. Watt, and I think your staff and others in these ongoing discussions. I think this is very important, about your line of questioning, that we do get some uniform bill to regulate subprime lending in this country of nonfederally regulated institutions.

Ms. WATERS. I appreciate it. I would like to see the information, and they should have it. Because if we have financial institutions who have a 6.5 interest rate and we have someone out there initiating a loan at 8 points or 7 points, I want to know how it all works, and is passed on to the consumer.

Chairman BACHUS. We have Secretary Jackson from HUD. We have had discussions with him. We have information from the Federal Reserve. We have a lot of HMDA data, and, in looking at the cost of these loans, of subprime loans, the yield spread premium is something that we have focused on.

Ms. WATERS. We have to do something about it.

Thank you.

Mr. OLSON. Congresswoman, we are involved in some hearings around the country at the moment. We will be in California on Friday, as a matter of fact. And during these the whole issue of the role of brokers has been an important part of those discussions, and the yield spread premium is a component of the broker relationship with the borrower. That has come up. I am disappointed, also, that I am not better informed about that and cannot add more to it.

Chairman BACHUS. Actually, you have informed us about the hearings on financial literacy and steering.

Mr. WATT. Mr. Chairman, I would like to make it clear that Ms. Waters was not walking out on you. She has a bill on the Floor, and I think she got focused on that.

Mr. OLSON. I promise you, I spent five-and-a-half years working for Members of the House and Senate, so I know the multiple types of responsibilities that you all have to balance.

Chairman BACHUS. I will say the Federal Reserve, as my understanding is, you all have been having hearings on the segmentation about race and ethnicity of the housing market—

Mr. OLSON. That is correct.

Chairman BACHUS. —and will continue to have those.

Mr. OLSON. That is correct.

Chairman BACHUS. At this time, in the order—the order of witnesses by seniority, which is what the minority side has asked me

to go by, Mr. Ford, Mr. Green, Mr. Clay, Ms. Lee, unanimously consent that you be allowed to have questions, because you are a member of the full committee and are one of the members who requested this specific hearing. So I would ask without objection that she also be allowed to ask questions.

Unless there is some direction as far as seniority, I will take my direction.

Mr. Clay.

Mr. CLAY. Thank you, and thank my colleague for yielding.

Mr. Olson, let me ask you about your comment on your testimony on page 9 where you say, "Yet the segmentation may have more troubling causes, at least in part. Segmentation may steer borrowers to lenders that charge higher prices."

Who does the steering? Which part of the industry does the steering?

Mr. OLSON. We have heard the range of responses to that question. I will tell you that some of the people who have addressed this issue in great detail are the people on the next panel. So that is an important question you ask, but let me give you some of what we have learned.

Number one, what we have learned is that people do in fact go to brokers or to lenders with whom they are comfortable or with whom they have repeat experiences. They also go to lenders that their principal advisor for financial products directs them to. There is a wide variation among how people determine who their primary advisors are.

There is also in the mortgage business among all segments of the business a great deal of marketing and we have uncovered—not uncovered but we are aware of what is called push marketing, where there is a very substantial—very aggressive marketing taking place, not all of which necessarily will lead a prospective borrower to the most advantageous product based on their needs and on their credit backgrounds.

Mr. CLAY. I don't want to cut you off, because I have a limited amount of time, but don't you think if borrowers don't know there is a better product out there that prevents them from getting—

Mr. OLSON. Indeed it does. That educational component is maybe one of the most important elements that we need to deal with; there is a knowledge asymmetry that is critical and growing.

Mr. CLAY. You also said that you are looking at 35 Federal Reserve regulated institutions that the 2004 HMDA data showed significant disparity based on race or ethnicity. How many of these institutions have outstanding CRA ratings, do you know?

Mr. OLSON. I don't have that information.

Mr. CLAY. Would you get us some data on that?

Mr. OLSON. With this caveat. We are very careful not to disclose the identity of an institution that we are examining, but I will try to correlate those two factors, the fair lending and CRA, to the best I can.

Mr. CLAY. My final question. Despite the value of the HMDA data for elimination of lending discrimination, there is no enforcement of the mortgage lending industry, the nondepository institution. This is a failure of the regulatory system. Why doesn't any other agency such as the FTC or the Justice Department aggres-

sively pursue supervision and enforcement of the fair lending laws with nondepository institutions? Is this a protected group? If not, why no aggressive enforcement?

Mr. OLSON. In our case, I say that, broadly, in the case of the financial institution regulator with prudential supervision, it is our role to go into those institutions on a regular basis, and in those institutions we are both examining for and expecting that they will have processes in place, and we will examine them for their compliance with the whole body of fair lending law.

By contrast, Justice and FTC, for example, are enforcers, as opposed to supervisors. It is a completely different paradigm. They are not funded or staffed to evaluate in the way we are. It is a different philosophy, a different approach to law enforcement.

Mr. CLAY. When you find practices of discrimination or something that is really overt, do you report them, too?

Mr. OLSON. To either HUD or Justice. It is almost always Justice.

Chairman BACHUS. Would the gentleman yield?

Mr. CLAY. I yield.

Chairman BACHUS. It is a referral?

Mr. OLSON. To the Justice Department. We have the authority to refer to HUD. For reasons that I can't tell you in great detail, they are almost always to Justice. Where we find evidence, significant evidence of discrimination that we would think perhaps is actionable, those are referrals to Justice.

Chairman BACHUS. From your fair lending reviews.

Mr. OLSON. That is right. There are enforcement actions that we can take independently, but where we see that level of evidence, it is a referral to Justice.

Chairman BACHUS. Congresswoman Lee.

Ms. LEE. Let me thank my colleagues for yielding and allowing me to ask my questions.

Let me go back to my point I made in my opening statement, Mr. Olson, with regard to CRA ratings. Of course, Congress created the Community Investment Act to make sure that banks are vested in strengthening communities in which they served and which they were collecting fees and in which they were doing business.

Now I can understand your response to Mr. Clay not wanting to give the exact names of the 35 institutions that you are reviewing at this point, but I also know it is a matter of public information, especially in California, that the top five, ten banks, their percentage of mortgage lending to African Americans and to Latinos amount to, from what I remember, between 1 and 3, 4 percent, yet these banks—again, it is public information—their CRA ratings were outstanding.

Now I have been trying for years to reconcile this, and Mr. Greenspan had indicated it was difficult to reconcile because the CRA statute did not focus on lending to minorities. But I guess what I would want to ask you is how do you think we can strengthen the statute so that we can at least have that information so we know whether or not the CRA ratings are really warranted? Because, quite frankly, an outstanding rating under CRA and mortgage lending to African Americans at 1 percent, something is not in sync, and I would like to get your ideas on how we can fix that.

Then, secondly, I would just like to ask you about the FICA scoring process, credit scoring. What do you think we can do to make that a bit more reasonable so that it works better for potential homeowners, regardless of their race or ethnicity?

Mr. OLSON. When CRA was originally passed, there was a concern that financial institutions were taking deposits out of a community—and however you define community, could be a neighborhood—but out of an area but not looking at meeting the financial needs of that community. And boiled down to its essence what the CRA requirements are intended to do was to have an institution evaluate the extent to which in its marketplace, however it defines its marketplace, and certainly one of the key determinants of the marketplace is where it has its deposit base and the extent to which it evaluates the needs of that community and then meets the financial needs of that community consistent with the product line that that institution offers. That is the criteria.

We take that very seriously in our evaluation and on an institution by institution basis, and I am sure that the banks have recognized this is a discussion that has gone on for some time, the extent to which that is really a serious process.

Ms. LEE. Let me comment here. The needs in many of these communities are varied, but home ownership is certainly one need, and the product line of many of these institutions are mortgages.

Mr. OLSON. That is correct.

Now those institutions have varying risk appetites. They might include a subprime lender or they might not. Some are very aggressive mortgage lenders. Some are very aggressive installment lenders. We don't ask all institutions to be all things to all people. What we ask them to do is evaluate how they are meeting the financial needs of their community as defined with the products that they have, and that is the criteria.

Now I can't answer on a specific institution by institution basis, but that is one of the reasons that CRA ratings are disclosed and one of the reasons that HMDA information is disclosed, to have the institution in the public arena defend how they juxtaposed the two.

Ms. LEE. I understand that, Mr. Olson. I am saying what resource is there, from a regulatory standpoint, for these institutions getting the outstanding ratings and yet they are flunking, on the most part, on mortgage lending to minorities?

Mr. OLSON. If in fact an institution is flunking, that would be a very difficult question to answer without looking at the specifics. Because it seems to me that what you have described is fundamentally inconsistent.

Ms. Lee. But it is a fact and we have been trying to get some answers to this for years. I am trying to, like many, find a solution. We haven't been able to get any response from the Federal Reserve with regard to how we can begin to fix this. So I would like to work with you.

Mr. OLSON. Very good. We will continue to—we will make a point of following up and give you more specifics.

Ms. LEE. Thank you, Mr. Chairman.

Chairman BACHUS. Mr. Ford.

Mr. FORD. I will be very brief.

Good to see you, Governor. You are a bright guy and brighter because you have a good guy from Memphis to work for you.

Mr. OLSON. Memphis is well-represented in the Federal Reserve, and we are the beneficiary of it.

Mr. FORD. You tell the other Governor that I like him, but I like her even more, so I am glad to see you.

Mr. OLSON. You like her more so?

Mr. FORD. She is a voter. I thank you.

Just a quick question. I won't take much time.

I have looked—what do you think the answer to this is? Because, obviously, that is what everybody is struggling to get at here. And Ms. Lee's frustration was not directed at you but years before she got here and the California gentleman's work on this and some of the others.

How do we get at this? Because we all see this data, it inflames emotions and provokes some policy reactions, and then we seem to be back here every year. The credit agencies claim they have nothing to do with it, the banks say they really have nothing to do with it, and it just kind of happens. Then you have people we represent stuck with the bill.

Normally, when rich people have a problem, they get a lobbyist and spend a lot of money and we get them moving up here. These folks can't do that. I don't mean to put it all on your shoulders, but how do we proceed from here? That is what we are trying to get at, and I know you are, too.

Mr. OLSON. If I can, Congressman, let me put that in a little bit broader context and describe what we see. What we have seen over the years and even incrementally from year to year, we see a significant increase in the number of mortgage applications, in excess of the population growth or even the adult population growth in this country.

So what we are seeing is significant increases in the mortgage market, providing mortgage financing to an increasing number of people. We also see efficiencies in the marketplace so that the products are available at a lower price than ever before, and the entire growth of the market has meant that more people, minority and nonminority, have access to more credit than ever in the past. That process, as best I can tell, is accelerating because of the numbers of lenders in the marketplace and the explosion in the secondary market particularly and the secondary market appetite for the conforming and nonconforming product.

The real difficulty that we see is that the increasing sophistication in that product means that the options available exceed the ability of even a fairly well-informed borrower to sort through all of the options available to them, and there are some—I don't remember who first said it, but there are some bad actors in the mortgage business. It is a small number, but there are some.

And what we are trying to do, what we have done through the regs and in the hearings, is to isolate those practices and those lenders. So what we can do is to preserve the advantages that mortgage financing has provided to allow more people to achieve home ownership but, at the same time, identify both the practices and the lenders that are abusive. And it is a combination. It is on

the one hand an educational process by the consumer. Certainly there is a responsibility that we ought to expect of the lenders.

Thirdly, I think that one of the greatest support mechanisms that we have out there are the community groups. They have been tremendous both in disseminating information, helping pinpoint the lenders that probably are abusive and then call those to our attention.

We have many banks in many markets partnering with community groups, and that is a process that we have strongly encouraged and certainly that is the regulators' responsibility on the oversight function. So it is a shared responsibility.

Mr. FORD. Do you think that the punishment should be greater?

Mr. OLSON. That is a legal question, Congressman, and I am not sure that—

Mr. FORD. Do you think if there were sterner penalties that it might deter some of this behavior?

Mr. OLSON. I think the penalties—it seems to me that the most significant penalty that you could provide to a lender, a responsible lender, would be just the reputational risk exposure. For a lender to be branded as discriminatory in their lending practices, for a responsible lender that is the worst thing you could say about them. I think, to me, that is the most significant deterrent.

Mr. FORD. I think you are right. That is a big part of it in some communities. But in some areas where people have limited options—that is the only concern I have. If you can only buy from one or two guys or women and they both have awful reputations but you have limited options, you don't have a real choice.

Mr. OLSON. You are hitting on an important point. Because one of the dangers that we see is that we are eliminating the numbers of people providing mortgage financing and to particular the minority communities. We have seen an increase in the numbers of lenders willing to aggressively lend. There is a downside to that. But I think it is important that we continue to remind lenders that we are encouraging additional lending into all communities, including the minority communities.

Mr. FORD. I have gone way over my time, but if this committee considers anti-predatory lending legislation, the Governor of my State is about to sign a law in the next few weeks probably. Your thoughts, do we need a national law on this?

Mr. OLSON. We have not taken a position, Congressman, on this.

Mr. FORD. I was hoping you were having such a good time you might break that rule. I appreciate your candor.

I am of the opinion that the States probably should act if we are not going to act this point and hopefully come up with a good plan. So you all have not—

Mr. OLSON. We have not taken a position.

Mr. FORD. Thank you for taking your time and forgive me for abusing mine, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Ford.

Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman and Mr. Watt, for hosting this hearing, and thank you, Mr. Olson, for your testimony.

Let's start, if we may, please, with a sentence on page 7 of your testimony. Midway down the first paragraph it reads, "Some of the

typical credit-risk factors not included in the HMDA data are credit scores and loan-to-value ratios."

If we had that information, would that alter your testimony greatly, sir?

Mr. OLSON. First of all, let me go back and make an important distinction. Those are factors that are not publicly available through the HMDA disclosures, but those are the factors that we look at very carefully and we do have access to when we examine those institutions.

So it lends itself to the question, can you make a decision, can you arrive at a conclusion from HMDA data? And even that additional incremental data would not allow you to arrive at a conclusion. However, our responsibility as regulators is to get into those institutions and look at their entire lending methodology, and those two factors become important in our analysis.

Mr. GREEN. In fact, in that same paragraph you go on to indicate that additional information about the lender, including loan products, lending practices, and borrower's credit worthiness; these are other factors that ought to be considered, and that would be important.

Mr. OLSON. That is correct.

Mr. GREEN. Is it possible, Mr. Olson, to construct an acid test, if you will, such that we can ascertain whether or not invidious discrimination exists with reference to lending practices? Is it possible?

Mr. OLSON. It is possible—well, that is exactly what our role is, and that is exactly what the Congress has asked us to do in the enforcement of ECOA and the Fair Housing Act, the body of law that constitutes fair lending. That is our responsibility and—as is with the other regulators.

If you were to have in the public domain enough information to definitively draw that conclusion, you would have had to lay bare the credit history and a lot of other personal data and a lot of other information of individuals that I think would be a fundamental breach of their right to privacy.

Mr. GREEN. You have indicated that this is a part of your function, to come to conclusions about price discrimination, invidious price discrimination, is that correct?

Mr. OLSON. That is correct.

Mr. GREEN. As a part of your function, given that you have access to information that is crucial in making such a decision about invidious discrimination, how many referrals have you made to the Justice Department? Assuming that you have found some cases of invidious price discrimination, how many referrals have you made to the Justice Department within the last 2 years? Let's start with 2 years.

Mr. OLSON. The pricing data—only recently has the pricing data been included in the HMDA disclosures.

Mr. GREEN. I don't mean to be rude, crude and unrefined, but I do need to intercede. Because I have to ask this. Has this been the charge of your institution for the last 10 years?

Mr. OLSON. That is correct. For the last—since fair lending—since ECOA and since the Fair Housing Act have been on the books.

Mr. GREEN. Approximately how many years?

Mr. OLSON. Twenty-five to thirty.

Mr. GREEN. In that 25- to 30-year period, could you give me just a rough guesstimate as to the number of referrals you have, given that this is one of the charges of your institution?

Mr. OLSON. Let me—I would be happy to follow up and give it to you more broadly, but let me give you the figures that I have today. In the last decade, we have made 33 referrals to Justice.

Mr. GREEN. In the last 10 years.

Mr. OLSON. Of those, I believe that the Justice Department has—3 of those 33 have actually resulted in action taken by the Justice Department.

Mr. GREEN. Thirty-three referred and 3 of 33—

Mr. OLSON. I have an update. In 2004 and 2005, we have made five referrals to Justice.

Mr. GREEN. 2004 through 2005, five referrals.

Mr. OLSON. Correct.

Mr. WATT. Could the gentleman yield?

For clarification, are you saying that 3 out of 33 in which legal action was taken, or any action was taken?

Mr. OLSON. In which the Justice Department took an enforcement action.

Mr. WATT. That is, filed a lawsuit.

Mr. OLSON. I have to get that. Including settlements.

Mr. WATT. So just 3 out of the 33.

Mr. OLSON. That is correct.

Chairman BACHUS. Would the gentleman further yield?

I think, as Governor Olson has said, this is only the second year that the pricing data has been available, and the Federal Reserve, to their credit, in 2002 started requesting this for 2004. So at least progress, I think, has been made.

Before, you said, actually, this data would be helpful. Have you found it to be helpful?

Mr. OLSON. Mr. Chairman, I suspect that those five referrals probably are information that predate our receipt of the 2004 information that we finally got in 2005.

Chairman BACHUS. What about the benefits as opposed to the cost of the data that you are now collecting? Could you give us an assessment of that?

Mr. OLSON. The Congress has mandated that we will collect the data, and so we do.

Chairman BACHUS. Have you found it valuable?

Mr. OLSON. There is no question but what the release—that HMDA and the public release of that information has caused lending institutions to very significantly focus on the issue of disparate treatment.

The additional information, the incremental information in pricing, that should not be new to any lender. Because we have been examining for compliance with that responsibility for at least a decade, also should not be new. But, even so, I suspect that lenders are much more attentive to that issue now that that information is in the public domain.

So I don't know that I can quantify an answer, but it certainly has had an impact.

Chairman BACHUS. That included census tracking information.

Mr. OLSON. Geocode information, yes.

Chairman BACHUS. Thank you.

Mr. Green, I yield back 2 seconds, if you have additional follow-up.

Mr. GREEN. Thank you, Mr. Chairman.

Permit me to ask about a term that I think I may have coined, and I simply called it O–U–T–I–N–G, outing. Did you out—3 of the 33, were they outed? Did we publish that they were engaged in invidious discrimination?

Mr. OLSON. The actions taken by the Justice Department were very public.

Mr. GREEN. The others, the 30, what was said or done with reference to their actions?

Mr. OLSON. I would have to guess how Justice handled them, and I would prefer not to do that. But I suspect that, for whatever reason, they decided that there was not sufficient information in order for them to bring action. That is strictly a presumption on my part.

Mr. GREEN. If I may, Mr. Chairman, may I ask one additional question? The Ohio law that has been referenced, I believe, earlier, if not, I am referencing it presently, it gives consumers the right to uncapped damages. We were talking about penalties earlier, and we talked about exposure as a penalty, and you gave your opinion about exposure as a penalty. What would be your opinion with reference to uncapped damages as a penalty?

Mr. OLSON. That is way out of my area of expertise, Congressman. The relationship between the penalties and the extent to which penalties may in fact deter behavior is way out of my range.

Mr. GREEN. Just a final comment, and I appreciate it very much, if exposure is within your range, it would seem to me that, as a penalty, that uncapped damages might be something that we ought to give some thought to. Ohio seems to be a part of the avant garde, and maybe this is where we are headed. I am not sure. But I do look forward to visiting with you more.

Thank you. I yield back.

Chairman BACHUS. Thank you.

Governor Olson, you have testified before the committee now for 3 hours with a small break, and I want to commend you for your testimony and your openness with this committee. I think that Government works best in this environment, and I think it is a wonderful opportunity to display a beneficial interaction between an independent agency of our Government and the Congress elected by the people. So I very much appreciate it.

We are going to have one follow-up question, unanimous consent request.

Mr. WATT. In this segment of the hearing.

Chairman BACHUS. Governor Olson, let me simply say that this committee has found on many occasions that home ownership is a key to financial independence, that affordable rental housing and home ownership are basically for most people the choice of where they will call home, and we have programs to promote both of them. Home ownership, as you know, builds strong communities,

and it offers children a safe and stable environment in which to grow and flourish.

Having said that, there is a concern that this committee has—members on both sides of the aisle—on what appears to be an opportunity gap between our White citizens, non-Hispanic White citizens, who have home ownership rates of about 76 percent, and our Hispanic and Black populations or citizens, who have home ownership between 40 and 50 percent. So a gap of about 25, 26 percent, which is a concern to all of us, and we would ask your commitment and we know that we have the Federal Reserve's attention and commitment to seeing that we mirror this opportunity gap.

Mr. OLSON. You indeed have our commitment on that, Mr. Chairman.

Chairman BACHUS. Thank you.

At this time, I will recognize Mr. Watt for unanimous consent.

Mr. WATT. Mr. Chairman, I ask unanimous consent to be allowed to submit for the record a report of the Consumer Federation of America entitled: New Analysis of Nontraditional Mortgage Borrowers Shows Less Wealthy, Weaker Credit Than Industry Suggests; second, a report of the Fair Housing Center of Greater Boston entitled: The Gap Persists, in which the Boston Center used testers to call and visit 10 banks and 10 mortgage lending companies in the Greater Boston area and found differences in treatment that disadvantaged minority home buyers in 9 of the 20 matched pair tests. That was 45 percent. Seven of these tests, the difference in treatment were large enough to form the basis for legal action.

So I am just submitting those for the record.

Chairman BACHUS. Without objection.

I would also like to submit for the record testimony submitted by the Consumer Mortgage Coalition entitled: Home Mortgage Disclosure Act, Newly Collected Data and What it Means, dated June 13th.

At this time, Governor Olson, you are free to leave.

We will start our second panel. Mr. Tom Price, a Member from Georgia, will preside for at least the first hour of the second panel. Thank you very much.

Mr. OLSON. Thank you, Mr. Chairman, and members of the subcommittee.

Chairman BACHUS. If our second panel will come forward at this time.

Mr. PRICE. [presiding] I want to welcome each member of the second panel, and I appreciate your patience as well. I know this has gone on a little longer that you have anticipated, but we thank you for coming and providing your testimony on this important issue.

Joining us on the second panel are Dr. Douglas Duncan, who is a senior vice president and chief economist, research and business development at Mortgage Bankers Association; Ms. Janis Bowdler, housing policy analyst, National Council of La Raza; Mr. Bill Himpler, executive vice president, federal affairs, American Financial Services Administration; Mr. Keith Ernst, senior policy counsel, Center for Responsible Lending; Mr. Calvin Bradford, president, Calvin Bradford & Associates Limited, on behalf of the National Fair Housing Alliance; and Professor Michael E. Staten, di-

rector, Credit Research Center, McDonough School of Business at Georgetown University.

We welcome each and every one of you. Please try to keep your opening statements to 5 minutes. The lights in front of you will show green until a minute is remaining; and then yellow will come on; and if you slow down enough, you won't get to the red, which comes on at 5 minutes to stop your testimony. If you can stay within these guidelines, it is appreciated.

We will have members come in and out and hopefully have a good round of Q and A, and we thank you once again for coming today.

Mr. PRICE. Dr. Duncan, if you would please begin.

STATEMENT OF DOUGLAS G. DUNCAN, SENIOR VICE PRESIDENT AND CHIEF ECONOMIST, RESEARCH AND BUSINESS DEVELOPMENT, MORTGAGE BANKERS ASSOCIATION

Mr. DUNCAN. Mr. Chairman, members of the committee, thank you. One brief change. Good afternoon.

I have been analyzing HMDA data for 14 years and believe that HMDA is an invaluable tool to understand how the mortgage market works in practice. Our HMDA work at MBA helps our members reach new customers and develop products and underwriting tools to better serve new and established portions of the market.

The most recent HMDA data on loans made in 2004 and 2005 demonstrate the greatest and widest availability of mortgage credit in our Nation's history, which in turn has made possible record home ownership rates. The data show that borrowers in virtually every area of the Nation of every race and ethnicity and every income level receive a wide array of credit opportunities.

HMDA is fulfilling its intended legislative and regulatory purposes of providing data concerning the availability of credit in order to help lenders, regulators and the public spotlight where additional lending may be needed. It reflects activity in the marketplace, provides usable information to facilitate public and private investment, and provides signals to regulators where further review is warranted.

The mortgage market is working. Statistical analysis of the data suggests that denial rates and differences in the incidence of minority and nonminority higher cost loans are explained by objective risk-related factors that are being applied in a nondiscriminatory manner. Absent overregulation and the imposition of unworkable solutions, the range of mortgage products and the risk-based pricing prevalent in the mortgage lending industry will continue to expand access to credit and record levels of home ownership. At the same time, competition will continue to compress rate spreads.

The market is working, but we recognize that it is not perfect. While risk generally determines rates, the effectiveness of borrower understanding and shopping cannot be discounted. Borrowers still find it challenging to understand the mortgage process.

Making financial literacy a reality is a good long-term goal, but we believe that there are steps we can take in the short term. First, borrowers need tools to educate themselves about the mortgage process; second, consumers need simpler, more user-friendly disclosures about mortgages in order to shop and compare; and,

third, consumers need to be urged to shop more intensively, comparing mortgage offerings from lender to lender.

Let me expand on that last point. Our research has shown that home buyers, particularly first-time home buyers, rely on a trusted advisor who may have an adverse incentive to help them through the complex process of buying a home and getting a mortgage. Too often, these new buyers, and particularly minority first-time home buyers, either contact only one lender or mortgage broker or are referred by a real estate agent to only one lender or broker while shopping for a mortgage. Borrowers more experienced in the process are generally more likely to seek additional rate quotes and are therefore more likely to receive a lower rate.

MBA opposes efforts to chill the innovation in our Nation's mortgage markets or in any way weaken competition. Some solutions that would actually harm borrowers include unnecessarily burdening lenders with additional data requirements and continuing to expand the patchwork of laws at the State and local level aimed at predatory lending.

Additional restrictions impose a cost, whether in increased compliance costs that are passed on to the borrower or through reduced competition as lenders make the rational decision that lending in certain markets is too risky.

Here is the conundrum facing lenders today. If they deny a loan, particularly if it is a request from a lower income or minority borrower, they risk being charged with red-lining or falling short on CRA requirements. If they approve a request, they risk charges of unsuitability or an unsafe or unsound credit decision. If they charge too much, they are accused of predatory lending. If they charge too little, they could be out of the business.

At this point, attorneys are telling businessmen what their business practices should be, but, despite the number of attorneys on this committee, that is not a good thing.

Those promoting unwise solutions to abuses in the market have misused the HMDA data to push their agenda. Press releases and inaccurate reports state that the differences in denials in higher rate lending among the minorities are unfair and discriminatory. More worrying, however, appears to be the wide-scale use of these reports to make public policy decisions where more scientific research reaching the opposite conclusion is available to legislators.

The mortgage market is working, and the innovation in this industry has benefited borrowers and increased the supply of credit, ultimately resulting in a higher level of home ownership than otherwise would have been the case.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Duncan can be found on page 78 of the appendix.]

Mr. PRICE. Thank you, Dr. Duncan. I appreciate your testimony.

Next is Ms. Janis Bowdler, the housing policy analyst for the National Council of La Raza. We welcome you.

STATEMENT OF JANIS BOWDLER, HOUSING POLICY ANALYST, NATIONAL COUNCIL OF LA RAZA

Ms. BOWDLER. Thank you.

Good afternoon. My name is Janis Bowdler, and I am a housing policy analyst for the National Council of La Raza. I would like to begin by thanking the chairman, the ranking member, and other members of this committee for hosting this important dialogue.

Though I don't have as much experience as my fellow panelists, I bring NCLR's expertise and perspective on this important issue.

As a funder of housing counseling, NCLR has been working with the mortgage industry for nearly 10 years to increase Latino home ownership. To better serve our clients, we have sophisticated partnerships with several of the Nation's top mortgage lenders. This allows us to understand the dynamics between lenders and the Latino community.

HMDA data is critical in this respect. It is the only publicly available data that gives insight into how lenders perform in certain neighborhoods among low income and minority individuals.

This morning, I would like to briefly describe what HMDA data tells us about Latino home borrowers and home owners, what is driving market disparities, and what more is needed from HMDA to complete the picture. Let me begin with what the 2004 HMDA reveals about Latinos.

In many ways, the story is not new. Latino families are twice as likely to be in the subprime market as Whites, 18 percent of Latino applicants are denied financing, and this is compared to 12 percent of Whites.

However, the release of the 2004 HMDA data gave us a look at disparities in product pricing. As you will hear later, Latinos are 30 percent more likely than Whites to be in the most expensive subprime products. Other minority communities have similar experiences.

In addition, NCLR's review of proprietary HMDA data from various lenders has revealed similar results. Latinos and other minorities are underserved by the prime market and overrepresented in the subprime market. These disparities are a clear indicator of market failure. Such market segmentation results in families wasting hard-earned income on access fees and interest, rather than on building wealth.

Moreover, these market disparities are not an accident,and centers built into the structure of the market drive segmentation. Allow me to explain.

A variety of underwriting variables common among Latino borrowers often require manual underwriting. For example, 22 percent of Latinos do not have credit scores. In a world of automated underwriting, manually underwritten loans are an unwelcome increase in time and resources. Not wanting the added expense, lenders process few loans of this kind. The excess demand is then forced to turn to the subprime market. Subprime lenders use a discretionary and proprietary pricing known as risk-based pricing. It focuses on placing clients in products that are profitable for the lender rather than suitable for the borrower.

In an effort to further cut costs and boost profits, lenders also rely on mortgage brokers. They help reach deeper into certain markets and cut branch expenses. Consumers rely on broker services, too, especially Latinos. Bilingual and bicultural brokers promote themselves as advisors Latinos can trust to find them the best

deal. However, lender-offered incentives known as yield spread premiums entice brokers to push the cost of the borrower's loan higher. YSP's add another layer of subjective pricing to already expensive and risky products.

NCLR's experience with the market busts the myth that such products are the only ones available to meet the needs of these hard-to-serve borrower profiles. Eighty-eight percent of NCLR's housing counseling clients are below 80 percent of area median income and many require manual underwriting, but all receive prime products. Instead, lenders are looking to cut costs, please their investors, and increase profits.

Still, more information is needed to accurately gauge the quality of services that lenders provide to minority and underserved communities. For example, loan-to-value ratios and credit scores are often considered the driver of mortgage prices. Those needed fields are not collected by HMDA. Moreover, HMDA is not as user friendly as it could be. The Internet offers the easiest access point for most, but not all, publicly available data is on the Web site.

To summarize, HMDA data provides the only publicly available picture of how minorities are faring in the marketplace. It reveals that Latinos and other minorities are not being served well by the mortgage market. They are forced to rely on subjective pricing models because of inadequate service by the prime market, and more information must collected under HMDA to allow for more in-depth analysis.

In closing, NCLR would like to make the following three recommendations: First, hold lenders and brokers accountable; create suitability in anti-steering standards for lenders and mortgage brokers; remove the barriers to HMDA analysis by adding additional data field so more robust analysis can be completed; and invest in housing counseling as a meaningful way to bridge the gap between underserved borrowers and their home ownership opportunities.

Thank you, and I look forward to your questions.

[The prepared statement of Ms. Bowdler can be found on page 90 of the appendix.]

Mr. PRICE. Thank you very much.

Next, Mr. Bill Himpler, executive vice president of federal affairs, American Financial Services Association. We welcome you.

STATEMENT OF BILL HIMPLER, EXECUTIVE VICE PRESIDENT, FEDERAL AFFAIRS, AMERICAN FINANCIAL SERVICES ASSOCIATION

Mr. HIMPLER. Thank you, Congressman Price. Good afternoon, Congressman Green and Congressman Watt.

I represent the American Financial Services Association and its 300 member companies, which include consumer and commercial finance companies, "captive" auto finance companies, credit card issuers, mortgage lenders, and other financial service firms that lend to consumers and small businesses across the country. This year, AFSA is celebrating its 90th birthday as the Nation's premier consumer and commercial credit association.

I am pleased to be here today to provide an industry perspective on the Home Mortgage Disclosure Act, also known as HMDA. Specifically, my comments will focus on the value and limitations of

the data collected under HMDA and why we think that the 2004 data demonstrates that risk-based pricing works.

First, let me provide some quick background on this law.

As has been stated, HMDA was first enacted in 1975 to identify and prevent red-lining. Therefore, lenders were required to provide data on the location of loans financed by property location by State, county, and census tract.

In 1989, HMDA was amended to require lenders to collect and report the race, sex, and income of every applicant and borrower, and, in 2002, HMDA was again amended to include rate information on higher rate loans. And, in 2004, lenders began reporting on this new data set, including the spread or the difference between the borrowers' APR and comparable Treasury notes.

While HMDA data can assist regulators in several ways, they do not present a complete picture of the mortgage lending process. That is because the data do not contain relevant risk-related and price-related information including the borrower's credit score, property type, down payment, any cash-out information, property value, the borrower's debt-to-income ratio, the loan-to-value ratio, and any assets held by the borrower.

Marketplace competition and the degree of borrower research and comparison shopping also are among the factors that typically determine the rate received by a borrower.

Without the information I just listed, HMDA cannot be used to draw accurate conclusions about why a loan was refused or made at a particular rate. Throughout 2005, the Federal Reserve explicitly cautioned that using raw data from HMDA alone could lead to faulty conclusions about lending practices.

The obvious question is: Why not require lenders to collect and report borrowers' credit and risk-related information that is used to price a loan and determine the rate that is charged; there are several reasons.

First, the release of credit scores and certain other data would undermine the privacy interests of borrowers. Second, the data elements utilized by lenders are numerous and weighted differently by different lenders and such weighting cannot be disclosed without undermining market competition and reducing invasion. Third, regulators already have the ability to review the individual loan files—let me say that again—individual loan files, which is really the only way to determine whether or not lending discrimination has occurred.

Even if all the data points that I mentioned earlier were collected and reported, HMDA data would still be incomplete. That is because some of the credit and risk-related factors that lenders rely upon are not captured electronically. For example: the data set does not capture the borrower's payment history related to past rent and mortgage payments; does not capture information related to the borrower's employment stability, such as whether or not the borrower has seasonal work or is an independent contractor; and it does not give an assessment of the surrounding neighborhood and value of nearby homes.

In its analysis of the 2004 HMDA data, the Federal Reserve reported that the risk-based pricing now used is working effectively. It has expanded access to credit and significantly contributed to the

highest levels of home ownership in our Nation's history. A record of nearly 70 percent of Americans now own their own home. Consumers are benefiting tremendously because mortgage lending is far more competitive than it was just 10 or 15 years ago. Today's unprecedented competition between lenders is keeping prices low and allowing consumers to shop around for a better-priced loan.

Finally, there is one point that I can't stress enough: Pricing disparities between borrowers who have different racial or ethnic background but identical personal and property risk profiles are unacceptable. The mortgage lending industry is committed to nondiscriminatory lending practices, and we continue to work with others who share our commitment to affordable lending to determine why any disparities exist so that we can take the necessary steps to eliminate them.

I appreciate the opportunity to be here today and would be happy to answer any of your questions.

[The prepared statement of Mr. Himpler can be found on page 96 of the appendix.]

Mr. PRICE. We thank you for your testimony.

Next is Mr. Keith Ernst, senior policy counsel for the Center for Responsible Lending. Mr. Ernst.

STATEMENT OF KEITH ERNST, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Mr. ERNST. Thank you.

I would like to thank Chairman Bachus, Ranking Member Sanders, and members of the committee for the opportunity to testify on recent developments related to the Home Mortgage Disclosure Act. Also, I would like to take this opportunity to specifically thank Chairman Bachus and Congressman Watt for their thoughtful leadership in addressing predatory lending and other interests vital to American homeowners.

In these brief remarks, I will discuss a recent study from my organization. In it we find that African American and Latino borrowers in the subprime market are commonly 30 percent more likely to receive a higher rate mortgage than similarly situated White borrowers. Before turning to the study, however, I wish to provide some context.

There have been longstanding concerns about potentially unfair pricing in the mortgage market. In 2000, a joint report by HUD and the Treasury Department noted that in predominantly Black neighborhoods, subprime lending accounted for 51 percent of refinanced loans in 1998, compared to only 9 percent in predominantly White neighborhoods.

Federal Reserve researchers recently noted in 2004 African American and Latino home buyers remained respectively 3.1 and 1.9 times more likely to receive a higher rate home loan, even after controlling for differences in income, gender, property location, and loan amount.

To help advance understanding, my organization brought together detailed information on loan prices, loan terms, and borrower risk profiles in a single database of 177,000 subprime loans made in 2004. As a result, we were able to ask squarely if race and

ethnicity were significant predictors of whether a borrower received a higher rate loan. As I mentioned, the findings were striking.

Even after accounting for objective factors that lenders used to set prices, including borrowers' credit scores, including loan-to-value ratios and borrowers' ability to document income, we report that African American and Latino borrowers in the subprime market remain commonly 30 percent more likely to receive a higher rate home loan.

When considering these results, it is important to understand that our analysis focused exclusively on subprime mortgages, those intended for borrowers with blemished credit. Also, our study did not evaluate patterns of loan approvals or denials. Rather, we illuminate troubling disparities in pricing. These disparities represent real barriers to economic progress at a time when the median non-White or Latino family continues to have just one-sixth the net worth of the median White family and substantial gaps in home ownership remain.

Even as I note the importance of these findings for specific communities, I stress that they have implications for all families. There is simply no reason to believe that the issues underlying these disparities stop at the color line. With this in mind, I offer several recommendations:

First, address industry practices that deviate from risk-based pricing and encourage inflated charges. The clearest example lies with yield-spread premiums. These cash payments give brokers a direct incentive to place borrowers in loans with higher rates. Including these charges in a revised definition under HOEPA would provide an important check against predatory lending and unfair pricing.

Second, holds lenders and brokers responsible for providing loans that are suitable for a given borrower. Investment counselors have long had such an affirmative obligation, yet while buying or refinancing a home is the biggest and increasingly most complex investment most American families will ever make, lenders and brokers frequently have no such obligation.

Third, require lenders under HMDA to disclose more detailed pricing information, indicate whether a loan was brokered, and provide information on key underwriting variables.

Fourth, encourage regulators to focus and make more transparent fair lending enforcement activities.

Finally, I recommend supporting a policy framework that promotes responsible lending. Especially critical to this objective are policies to end abusive lending so responsible lenders can successfully compete to meet all families' credit needs. Along these lines, State predatory lending laws provide a useful model as they work to filter abusive loans while allowing credit to flow.

In closing, I recognize that every member of this committee shares the ultimate goal of fairly priced credit and the resulting opportunities to build wealth for all families. The 2004 HMDA data shows that we have substantial work ahead to realize this goal. Thank you for your consideration.

[The prepared statement of Mr. Ernst can be found on page 101 of the appendix.]

Mr. PRICE. Thank you very much for your testimony.

We now have Mr. Calvin Bradford, president of Calvin Bradford & Associates, on behalf of the National Fair Housing Alliance. Mr. Bradford.

STATEMENT OF CALVIN BRADFORD, PRESIDENT, CALVIN BRADFORD ASSOCIATES, LTD., ON BEHALF OF THE NATIONAL FAIR HOUSING ALLIANCE

Mr. BRADFORD. Thank you.

I am speaking here today on behalf of the National Fair Housing Alliance, or NFHA. I want to thank Chairman Bachus and the members of this committee for inviting us to these important hearings.

Professionally, I have worked in the field of fair housing, fair lending, and community reinvestment for 35 years. NFHA was founded in 1988. I have worked with this organization on many of its extensive educational training and enforcement programs in fair lending.

Today, I want to make five key points:

First, the Home Mortgage Disclosure Act data are widely used and extensively valuable in fair lending and community reinvestment activities. Since these data were first released, HMDA has become the pre-eminent source of comprehensive data to track patterns and trends in mortgage markets. Community groups, civil rights attorneys, governments at all levels, financial regulatory agencies, and lenders have used the data literally thousands of times each year to address fair lending. These uses range from identifying lenders for testing to developing programs that have created literally billions of dollars in private reinvestment programs.

However, improvements can be made. For example, the HMDA data software programs could be more user friendly for community based organizations and others with limited resources. We also recommend that HMDA be enhanced to include the identification of loans processed through mortgage brokers, that interest rates and fees be reported separately, and that the FFIEC consider whether a single pricing index really is appropriate for all HMDA loans.

Second, fair lending enforcement by the Federal enforcement agencies is critical to eliminating housing discrimination.

Private lawsuits have historically been the mainstay in efforts to combat lending discrimination. While these private efforts are important, the full engagement of Federal enforcement agencies is essential for any serious effort to combat lending discrimination in its many forms. Typically, in order to show that a member of a protected class was treated illegally, one needs to know how other applicants were treated. This requires access to proprietary information that is not in the public domain. Most victims of discrimination are unlikely to know that they have been discriminated against, especially where deception is involved and misleading or fraudulent practices.

Private organizations simply do not have the resources to undertake this type of investigation and litigation on a routine basis. Lack of aggressive Federal enforcement actually provides a form of safe harbor for those engaged in discriminatory activity.

Third, the Federal regulatory agencies must improve the quality and the scope of their fair lending enforcement activities.

The Federal agencies that regulate depository institutions have the authority to conduct effective fair lending exams. However, in the experience of many of us directly involved in training, education, and litigation, the record of enforcement falls short of the mark.

For example, in the case of Flagstar Bank, the OTS raised its CRA rating from satisfactory to outstanding after it was found liable for overtly discriminating against an entire national class on the basis of race in a Federal court. Moreover, the discriminatory policy was implemented while the bank was being examined.

Fair credit lending exam procedures themselves sometimes reflect the fundamental lack of understanding of fair lending. For example, find the examination procedures actually instructing examiners that it is an indicator of potential discrimination if the same loan officer is allowed to provide an applicant with applications, or options, for the prime and subprime loan product of that lender's mortgage companies.

On the other hand, this practice was seen by fair housing groups and many of us in the field as essential to fair lending.

We recommend that Congress should exercise its continued oversight authority to determine why discrimination that is so often identified by private enforcement efforts is so seldom uncovered by fair lending exams.

HUD, Justice, and the FTC must increase their fair lending enforcement efforts. HUD is the main enforcement agency under the Fair Housing Act. However, it has undertaken very little fair lending enforcement activity. The Department of Justice was the lead agency in establishing some landmark cases in the 1990's, but its enforcement activity has declined since then. The Federal Trade Commission has the authority over nonregulated lenders under the Equal Credit Opportunity Act, but it has pursued almost no lending discrimination cases.

In this environment, Congress needs to allocate additional resources to HUD's Office of Equal Opportunity and to the Fair Housing Initiative Programs in order to support increased educational enforcement efforts on the part of private fair housing organizations.

Finally, but not least at all, no agency regulates independent mortgage companies for fair lending compliance. There is a vacuum of Federal enforcement of nondepository institutions which account for the majority of loans in the market today. This is an especially severe problem in the subprime market and in the wholesale market, where most lending is done through unregulated brokers.

In addition to HUD, Justice, and the FTC, we believe that the Federal Reserve should take more aggressive action to ensure that bank holding companies and all of their affiliates are in compliance with fair lending laws.

This conclude our comments.

[The prepared statement of Mr. Bradford can be found on page 110 of the appendix.]

Mr. PRICE. Thank you, Mr. Bradford.

Finally, we have joining us today Professor Michael Staten, who is the director of the Credit Research Center at the McDonough School of Business at Georgetown.

STATEMENT OF PROFESSOR MICHAEL E. STATEN, DIRECTOR, CREDIT RESEARCH CENTER, MCDONOUGH SCHOOL OF BUSINESS, GEORGETOWN UNIVERSITY

Mr. STATEN. Thank you, Congressman Price, and members of the committee.

As the last of six panelists, and after extensive Q and A with Governor Olson, I run the risk of sounding like a broken record. Nevertheless, I will plow forward and get right to the point.

HMDA is designed to provide information about the extent to which mortgage loans are available to borrowers across neighborhoods and across income and racial groups. The data are very good at that original purpose.

With the addition of pricing data for some loans, the HMDA data more accurately identifies the location of subprime lending activity, as well as higher-cost loans under HOEPA coverage. As such, the database is a gold mine for researchers and also for marketers seeking to identify certain neighborhoods that may be ripe for competition. However, the HMDA reporting process was never designed to replicate the data collection that mortgage collectors undertake during the underwriting process.

It can jump-start for the regulators a fair lending analysis because it indicates the price of the loan that is actually charged. But far more characteristics about the borrower and the property and the loan itself are omitted from HMDA than are included. So the HMDA data by itself cannot be used to draw any conclusions about the appropriateness of pricing.

That should not come as a surprise to anybody, because the Federal Reserve has repeatedly noted for the last several years that it is going to use this new pricing data purely as a screening device to identify institutions for closer scrutiny and inspection of the loan files. It looks for pricing disparities that can be accounted for with the HMDA data itself and then flags institutions and loan products for a closer look at the actual files. The HMDA data help it to focus that resource-intensive process.

One of the lessons that was pretty effectively demonstrated in the Fed's bulletin article last fall was that differences we observe across racial groups in the likelihood of receiving a high-price loan narrow as more information about risk-related factors is added to the analysis. Characteristics of the loan, such as the size of the borrower's down payment and whether the interest rate is fixed or adjustable, account for some adjustments in loan price, but they are not reported under HMDA. Characteristics of the borrower, like credit score and total debt relative to income, and delinquency history, also affect the price, but they are not reported under the HMDA.

You are undoubtedly aware that different research groups, including my own, have used different loan bases with different variables, and we have all found that when information is added to the HMDA-reported data, pricing disparities shrink. We all acknowl-

edge that the databases we use do not contain all of the risk factors that lenders consider when pricing a loan.

I picked up from comments made earlier in the hearing that there is this illusion that some of these studies actually control for everything, but they do not. All of them are short some of the information that is present in the loan files but not present in the electronic databases that are utilized.

So there are really two messages here. The first is that analysis of pricing fairness is greatly affected by the amount of information about both the borrower and loan characteristics. The second message is that when available data are known to be incomplete, analysis must be preliminary and no conclusions from that analysis are possible.

The Federal Reserve has been saying this repeatedly for more than a year. Call it, "the inconvenient truth" of the HMDA data. The fact is that no study based on HMDA data alone can generate a conclusion that any lending institution has violated fair lending laws, nor can studies like our own or the recent study by my colleagues at the Center for Responsible Lending that utilize an expanded but still incomplete set of loan level characteristics. Good intentions notwithstanding, this sort of statistical effort is destined to fail. The data just are not up to it.

The only way to reach defensible conclusions about fair lending practices is through a combination of statistical analysis and loan file review through the examination process. That is exactly the approach, apparently, that the Federal Reserve is using.

In my written testimony I refer readers to two papers by agency economists that present results from actual fair lending exams. Both papers demonstrate rather convincingly how inspection of loan files can significantly alter conclusions reached through portfolio-wide statistical analysis alone.

It is certainly reasonable to ask, and it has been asked several times already this morning, if more statistical information would be helpful. Wouldn't it be a good idea to require more detail as part of the HMDA reporting requirements? I think the answer to that depends on the extent to which reported items would be publicly disclosed.

The requirement that lenders provide more detail to the Federal Reserve for its internal use only might help to focus their pricing disparity analysis and focus those resource-intensive efforts by telling them which loan files to look at.

Now suppose that the expanded reporting requirement would also include public disclosure of the data elements, just as current HMDA data are disclosed. It seems to me that this is a very bad idea, because the process would quickly compromise the privacy of borrowers.

The Federal Reserve staff have already demonstrated that it is possible to match publicly available HMDA data with publicly available information on property transfers to identify the race and income of owners reported under HMDA right now with a high degree of accuracy. Federal Reserve staff indicate that for more than 90 percent of loan records in a given year's HMDA data, that the lender reports only one loan in a given census tract for a specific amount. If you know the lender, the census tract and the loan

amount, you can match it with publicly available property records and determine the identities of borrowers. With that match, any item in the HMDA database is publicly known.

Public release of data on credit scores and other borrower attributes is virtually unthinkable, given today's regulatory commitment to privacy protections, and it still would not give the public all the information necessary to draw fair lending conclusions.

Thank you very much, and I would be happy to answer questions.

[The prepared statement of Professor Staten can be found on page 128 of the appendix.]

Mr. PRICE. Thank you, Professor Staten. We appreciate it. We thank you very much for your testimony, and we thank you for your participation. It is very valuable information you brought to us today.

I should have mentioned before you began that, without objection, your complete written statements will be made a part of the record.

We have scheduled some votes within a relatively short period of time, but I think we can probably get through questions. We will begin with Mr. Watt, and I recognize Mr. Watt for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

Let me first commend all of the witnesses and reassure particularly Professor Staten that we have no illusions that HMDA data is the end-all to all the questions that are out there. If we did, I suspect a number of people would be running out the door to file lawsuits based on discrimination.

I think all of you have demonstrated that there are a number of factors that go into determining what lender rates will be and conditions and terms of a loan will be, and for that reason borrowers are having trouble sifting through all of these factors. I think it was said there were about 30 of them. Representative Baker named a bunch of them, including the time of day.

We know that loan decisions are complex, but we still get back to the end of the day—a recognition that I think Mr. Himpler made, if I can find his testimony, that at the end of the day pricing disparities between borrowers who have different racial or ethic backgrounds but identical personal and property risk profiles are unacceptable, and I do not think any of us, industry, Members of Congress, anybody thinks that some of that is not going on. So we get back to Representative Ford's question, and probably the fairest thing to do is to ask Mr. Duncan and Mr. Himpler to address this.

It is implicit in Mr. Himpler's statement where he says, "We continue to work with others who share our commitment to affordable lending to determine why any disparities exist so we can take the necessary steps to eliminate them." It raises the question, how do we get there from here? In a market that is very viably complex, where everybody's intentions are good, rate differentials, loan differentials are still taking place, how do you suggest we do that?

We do not want to increase the burden of paperwork. We do not want to make life more miserable for lenders. We simply want to eliminate any unacceptable factors from being considered. How do we do it?

Mr. HIMPLER. Well, since you are referencing my testimony, I will take the first shot at it, and I have a feeling that my colleague, Dr. Duncan, will elaborate more fully than I can.

Mr. WATT. If I referred to him as Mr. Duncan, I'm sorry. Dr. Duncan.

Mr. HIMPLER. I think at this point we do not want to get the cart before the horse. It is probably imprudent for me, Congressman, to ask the members of this committee to please be patient, but, essentially, that is what I am asking as a representative of the mortgage industry.

A number of our members have just reported HMDA data for the first time in 2004, which is why the Federal Reserve worked so hard to crunch the numbers. They have now made referrals from the 8,500 plus lenders from whom they reviewed data. They made referrals for further investigation to the regulatory bodies that Governor Olson mentioned, including the Federal Reserve.

My hope is that at the end of the day, as those investigations come to a conclusion, that—and I would encourage members of this committee to request that of the regulators—to report to this committee and to Congress what findings they had. Let's let the process work itself out. They have the ability. They are looking at individual loan files, and only by looking at individual loan files can you determine whether or not discrimination is taking place. But it is going to take a little bit more time.

Mr. PRICE. Dr. Duncan, if you would like to.

Mr. DUNCAN. Certainly, Congressman. Not to worry about the title. Only my mother has permission to call me doctor, typically.

I think the best way both to reveal any inequities and to ensure that they do not emerge has two parts. One is on the lender side and the other is on the consumer side. On the lender side, what you need is vigorous competition so that someone who is discriminatory is revealed to have pricing, whether in dollars or quality, that is outside the market and the market bids the business away from them by doing a better job.

Oversight over that lender requires vigorous regulatory oversight and well-funded support for that oversight for existing laws prohibiting fraud and discrimination. That is something that we have argued for for some time and is still not fully there.

On the borrowers' side, what borrowers need are three things. First, they need good information that is understandable, to understand the mortgage process from beginning to end, and that has become ever more important as some lenders now have 200 to 300 loan products that they offer. Second, they need clear, understandable disclosures of the loan terms so they can understand how the product works so that they can shop it from lender to lender. And third, they need all the encouragement that they can get to shop from lender to lender and make the market forces work for them.

We have done some survey work that showed—and this was about 4 years ago—of the thousand people who bought a home, not refinanced but bought a home, one-third never talked to more than one party in the entire transaction. Well, if you happen to get one of those bad actors you are leaving yourself open to abuse because you did not activate the power of the marketplace.

Mr. WATT. I plead guilty to that. Most borrowers will.

Mr. PRICE. The gentleman's time has expired.

Mr. ERNST. If I may add one note to that. I disagree that consumers need more information and encouragement to shop around. I think one of the things that has become very clear to ask, working with the data being involved in this to date, is that consumers also need confidence that there are a set of policies in place that protect them and promote their best interest.

If we talk about 200 or 300 mortgage products out there in the marketplace, that really is a bewildering array. I think that is why one of our strong recommendations at this point in the debate is the focus and the protections, including suitability requirements, and ensure that some of that high-quality information for a while may come from the mortgage broker, the person sitting across from the table, who is really in many ways in the best position to provide that information.

Mr. PRICE. Thank you.

The Chair recognizes himself for 5 minutes. I just want to thank you all very much for coming. Your testimony and this information has been very helpful, at least in my education process on this.

I am also struck by the number of outliers that you note, Mr. Himpler, and I note that we look forward to that report and see what information they glean.

I was also struck by the time of day being part of how a mortgage turns out in terms of offer. I have noted that is true for purchase of cars as well, time of day, and day of the month. So it is indeed an education process.

I have just two kind of overarching questions for anybody who wants to take a stab at them.

One is, is there any role at all for subjectivity in the granting of a mortgage? And anybody is certainly welcome to take a stab at that.

The second one, in view of Mr. Himpler's and other's testimony, I wonder if it is possible—Professor Staten touched on this as well—to collect adequate data that can either confirm or disprove that discrimination is in place.

So kind of those overarching questions, if anybody wants to take a stab at them. Mr. Bradford.

Mr. BRADFORD. I would like to start with the second one.

I think the real purpose of the Home Mortgage Disclosure Act has been to try to respond to the market as it has—over the years, it has changed and added information in order to be able to highlight the areas, to sort of focus light on the areas where disparities exist so that the real, substantive, detailed analysis investigation can take place.

I do not think it is reasonable to assume that you are going to be able to re-underwrite every single loan by some set of public data, because of the vast number of loan products and flexibilities and guidelines that exist. That I think brings us back to the importance of there being a Federal enforcement effort, because those agencies have the authority to go and investigate those cases. It looks like half of these 200 lenders that I find in the Federal Reserve's analysis are essentially unregulated lenders, and we do not know what is going to happen with looking intensively at their pat-

terns. We have the regulatory agencies responding to the ones covered by them.

Just in passing, I would just comment, sometimes all of us who have degrees in statistical analysis have done a terrible disservice to everyone, because there seems to be an impression that statistical significance is sort of the end-all to defining these issues, and I think it relates to a subjective question. Statistical analysis is not going to help you with the marketing programs where lenders serve different channels and different groups and populations for different channels. It is not going to resolve internal decisions people make about whether to grant exceptions and make subjective decisions that are informed and that should be guided by policies of the lender but nonetheless they are not. They are not something that you can incorporate in the underwriting system. They still are subjective.

I work with the Fair Housing Act, and the Fair Housing Act does not say you can discriminate until you pass some threshold of statistical significance. If you violate anyone's rights, you have violated the law.

Also, in the Federal Reserve analysis, statistical significance is driven literally by the size of your groups. Therefore, you can see statistical significance in a whole market, but when you pick a particular lender and then a particular set of loan products and then a particular set of characteristics to match on, you are likely to end up with a group that is so small that it really is mathematically impossible if there aren't statistical differences, even if people were treated totally differently.

So we have to be careful, that you might have sensed that somehow the statistical difference is important and the examination procedures literally allow the examiners under conditions to use the statistical significance difference and statistical measures instead of their full exam procedures. So I think we need to focus on those subjective ways in which they examined the way the decision actually got made.

Mr. PRICE. My former statistics professor appreciates your disclaimer.

Mr. Himpler.

Mr. HIMPLER. Yes, a couple of comments, Congressman. You made mention to my reference to the 200 outliers. I do not want anyone to take away from my commentary this afternoon that I would characterize those either finance companies or financial institutions as outliers. They are going through the process. The HMDA data pointed to the possibility or the need for further investigation, and until they are investigated fully then they are not really outliers.

But I did want to make one other comment, because it has come up a number of times. We are talking about federally regulated financial institutions and nonfederally regulated either financial institutions or finance companies, a number of which I represent. I think it is important for the members of this committee to remember that a number of the finance companies that are not federally regulated are very well-regulated at the State level. A number of members have even commented that the States should be taking a lead in that. As a corollary to that—and I appreciate Congress-

man Meek's comments earlier—making a distinction between subprime lenders and those that abuse the process.

It is important to remember that the progress that we have made over the last 10 or 15 years in the mortgage lending arena has largely come through subprime lending and digging deeper and deeper into the consumer market. So that we are not talking about pass, fail, approval, denial. We are talking about rates. That is where the debate should be.

Mr. PRICE. My time has expired, but Ms. Bowdler if you want to comment.

Ms. BOWDLER. Thank you.

I just want to pick up on the idea of subjectivity.

There is an earlier comment—there has been a lot of talk about the number of products that are out there for people. Say there are 200 products. It is quite conceivable that I am going to qualify for 10 or 20 of those products. So, when sitting down in front of a lender, how our families end up in one product over another when they could qualify for, say, any fraction of those 200 really has to do with what are the motivations of industry. And I am just going to go that, hands down, they are always going to put them in the loan that is most profitable for them. That is just the nature of the beast. The business want to turn a profit, and it needs to do so in order to continue to serve consumers.

But what we need is something to offset those motivations, some incentives to make sure that the concerns of the borrower are represented. So there are a couple of things that have been talked about.

If you would indulge me for just one moment, I have brought an example, this question of subjectivity, of how people end up in the various loans that they do and is there room for subjectivity.

I have with me the Casa section from the Washington Hispanic and the Real Estate section from the Washington Post, both from this month. I went through the Casa section, and there is not one advertisement in here for a standard prime product. They are all 100 percent financing, payment option, adjustable rate mortgages with a teaser rate, and that includes both mainstream institutions and mortgage finance institutions. If you look at the English language newspaper in the Washington Post, I did not find any payment option mortgage advertisements. I see lists and lists of standard 5/1 ARM's, standard amortizing product.

So when we are talking about room for subjectivity, I think there is, but what we need to talk about is also how to offset the profit motivations of industry to make sure that consumers are treated fairly.

Mr. PRICE. Thank you. My time has expired.

Mr. Green, you are recognized for 5 minutes.

Mr. GREEN. Thank you very much.

I am concerned about the impact of the newly passed Ohio predatory lending law, and my assumption is that some of you will be familiar with it. It imposes a good-faith standard for brokers and lenders. It gives consumers a right to sue for uncapped damages, and it creates a database of loan officers who violate the law and make available that database on a Web site. Now the question is,

what impact do you think this newly passed law will have on lending practices? And I welcome all of you to give your opinions.

Mr. ERNST. It seems we may not have any Ohio law experts on the panel, but I will say, in terms of the broker obligations that you discuss in the Ohio bill, that North Carolina and several other States have had obligations that they have placed on brokers, and I know that our banking commissioner, Joseph Smith, has talked about the importance of those standards in terms of making sure that borrowers are finding their way to good products.

I think the other thing that I am aware of in the Ohio law that is an interesting lesson perhaps for this committee is that yield spread premiums themselves are subject to scrutiny. So, in other words, when the loan is evaluated, to determine whether or not the incentives in place at time of origination to the mortgage brokers—in other words, how much was the mortgage broker walking away from the table with, that measurement is comprehensive. So yield spread premiums, up-front payments to the mortgage broker are all measured to determine whether additional protections are put in place.

I will say that that kind of provision in other States has proven workable. So I think, while it is probably too early to judge a law that I do not think has actually been signed by the Governor yet, I think there are some good, optimistic provisions in there that could serve borrowers well.

Mr. DUNCAN. Likewise, our organization, being a national organization, not experts in the State law, but as an economist just listening to your comments on some of the provisions, they will impose costs on the businesses within that marketplace and they could be observed in one of two ways. Either they can be observed in a shrinkage of lenders serving that market and then the overall pricing structure in the market rising for consumers and pricing some people out of the marketplace, or they could simply be passed through to consumers in the form of higher costs. But I am not sure if the law has been signed into law by the Governor yet, but we will certainly take a look at it when it takes place.

Mr. HIMPLER. Until then, Dr. Duncan, my fear is that at the end of the day it may drive lenders out of the community that are serving the community in the State of Ohio and doing a good job there. But because of the risk of exposure they cannot afford to stay in the various communities that they are currently working in. The result from that is the possibility that folks who may have been right on the fringe, if you will, of being able to afford their first home may not be able to go to those lenders because they are no longer there, and they are forced to go to the nefarious folks that we are all concerned about, driving them directly into the hands of the people that this hearing is trying to address.

Mr. ERNST. I guess the thing that I would put on the table for consideration is that there is another possibility to have allowable, will be able to be implemented, and that is that consumers will find themselves having the luxury of additional consumer protections that will make a real difference in the quality of the loans they receive. It will eventually cut down on foreclosures and help borrowers in preserving their wealth.

That has been the intention of State predatory lending laws, and research from my organization, from most senior economists at the Federal Reserve Bank of St. Louis, shows that, by and large, the predatory lending laws are now leading to large decreases in access to subprime creditor to credit overall.

I think we should keep in mind squarely one of the benefits that come with these laws, which are considerable—and we should, of course, take every law on its own merit—but I do not want to lose sight of the fact that these laws are, in fact, providing enormous benefits to borrowers in the States that have them.

Mr. BRADFORD. I think you have an example of a lot of States trying to come to grips with the process of dealing with the brokers. Because even the lenders cannot control the brokers. Because if you decided not to do business with a broker because you do not like their behavior, they just go and do business with someone else. So they are not an employee.

So it is one of those difficult situations where we see the key actor in the market that is often the focus point, particularly of some of the fraud and abuse, is an actor that is very hard to control. So what you really have are people exploring ways in which they can try and deal with that without shutting down the market, I think, in response to those issues. The market has become so competitive among lenders. I think legitimate lenders with good resources and decent products are going to be so competitive that if a particular broker leaves the market, other people are going to deal with that pretty rapidly.

Mr. DUNCAN. Just to pick up on the research, I think there is also a compelling body of research that will show that, in fact, access to credit has declined in some of the States that have passed fairly punitive laws with regard to predatory lending.

With regard to the flow-through, of how lenders deal with brokers, there is a market mechanism which picks that up. The secondary market today prices mortgage-backed securities and mortgage-related assets quite competitively, in fact, globally. Perhaps 15 percent of U.S. real estate assets are funded with global capital inflows to the United States. That flows through to the borrower level very quickly in this very efficient market that we have, and lenders keep a scorecard on their brokers where they evaluate the quality of the loans that come through and into the secondary market. If quality suffers, then the lender suffers with disadvantageous pricing, and they therefore maintain the scorecard to cut off brokers and push them out of the system.

So there are some structures that help protect consumers that are inherent in the marketplace.

Mr. PRICE. The gentleman's time has expired.

Mr. GREEN. Thank you, Mr. Chairman.

Mr. PRICE. Thank you.

I want to recognize Mr. Davis for 5 minutes. But, before I do, I will have to leave, and I thank the Chair for allowing me to preside.

Mr. DAVIS. Thank you, Mr. Price.

Let me, if I can, take the panel back to the observations that I made during the opening statement, and the question was the standard that, frankly, is owed someone who comes into an office

for a mortgage transaction. Let me just ask the question fairly directly, and I want to hear from people from the industry. I guess that is Dr. Duncan and Mr. Himpler. Briefly, what do you all consider the standard or the duty of care to be at present between consumer and mortgage broker or mortgage banker?

Mr. DUNCAN. We believe that every credit-worthy borrower should get the credit in the form that they seek it and that they are qualified for.

Mr. DAVIS. And obviously we have an issue as to whether that happens or not.

Do we believe that the mortgage broker, the mortgage banker, whoever is involved on the business side of the transaction has a duty to notify the consumer of the best and optimal credit to which he or she is entitled?

Mr. DUNCAN. Let me give you a recent anecdote as an introductory, and then I will close it.

I was speaking with a reporter who reports on the housing markets, and in particular the subject was the different loan types that are available. So I asked her, do you have a mortgage? And as it turn out she had recently—this was in January of this year—she and her husband had recently purchased a home.

So I asked what kind of a loan that they used. They used a 5-year, fixed-rate, interest-only loan. And I said, well, that is interesting. You are reporting on that. What are you telling people about the dangers of those loans? Because she was asking questions about their dangers.

She said, well, in our case, my husband is on a low monthly base salary and receives commission and at the end of the year a bonus. So we simply pay the principal when he receives this bonus, and the loan amortizes as fast or faster than if we had taken, say, a 30-year, fixed-rate, level-payment, self-amortizing mortgage.

So the question really revolves around whether it is the lender that has better insight into how the household intends to manage their finances or the household. Because the household qualified for a fixed interest rate, 5-year, interest-only loan, they could probably also get a 30-year, fixed-rate, level-payment loan. But they made a decision because of the structure of the household finances that worked better for them at that time.

Mr. DAVIS. Mr. Ernst, Ms. Bowdler, let me pose the same question to you all. Do you believe that the standard mortgage industry is what has been described by Dr. Duncan?

Ms. BOWDLER. Let me start by saying that, when it comes to all of these products, subprime products, the alternative mortgage products that we have been hearing so much about, like the interest-only product that was just described, are certainly legal products that are suitable for some people, but they are not suitable for all people. And we have talked a little bit about various—subjectivity about who gets these loans and how to make all of these decisions, which I think was inherent in Dr. Duncan's anecdote.

But what we do not see in the industry right now is any obligation on behalf of mortgage brokers specifically, but also on behalf of lenders, to ensure that the borrower is in fact getting a loan that they have the ability to repay that is suitable for their cir-

cumstances, or that they are not steering to a loan that is more profitable for themselves.

Given the structure of the marketplace which has built-in profit incentives, I think there is definitely a need for a suitability standard that will offset that structure.

Mr. DAVIS. Let me pose the questions—because my time is running. I want to pose a question on the industry.

Dr. Duncan or Mr. Himpler, either one of you, what happens right now to a mortgage broker, for example, who falls short of what you describe as best practices in the industry? What is the punishment in effect for a broker who does not follow best practices? Is there one?

Mr. DUNCAN. If the broker commits fraud—

Mr. DAVIS. Not fraud. There is a difference between fraud and best practices. It is kind of like for us. There is a difference between good practices and what will send you to jail.

Mr. HIMPLER. I do know that a number of lenders have certain standards that they apply to brokers, and if they fall below those standards they do not use those brokers anymore. But, as was stated earlier, those brokers may go and do business with some other lender.

But if I could take just a moment, Congressman, to get back to your initial question as to how the standard—I think you used the legal profession, which I am also part of, or the medical profession. I think it is important when you are talking about mortgage products, because what you are talking about is a consumer product, not a professional service. And you can tell whether or not you as a lawyer are providing the best service to your client. I am not going to be so presumptuous to determine what is the best product for a given consumer.

We have heard of a couple of examples already. I am glad Ms. Bowdler mentioned the ability to repay. AFSA has that as one of its voluntary standards that all of our members have to agree to, to be a member of AFSA, is to abide by an ability to repay standard. I think that is an equitable way of going about it.

But when we get into the area of suitability, we run into dangerous ground. Because whereas it might be suitable for customer "A", it may not be suitable for customer "A" who is trying to buy down in order to be able to afford more house than they might otherwise do.

Mr. DAVIS. Let me make one observation, since my time is up.

Mr. Ernst, I know you are dying to say something. Let me make my closing comment on this.

What is different, though, Dr. Duncan, Mr. Himpler, all of you on the panel, by definition when these transactions happen, the prospective buyer, if you will, is obviously at an informational disadvantage, typically at a sophistication level disadvantage, at the ultimate disadvantage that he or she really wants to buy the home and does not want to really know a lot beyond that at the moment, and the person in the superior position when it comes to information, when it comes to detachment, if you will, is the person who is on the seller side or on the lender side. Given that disparity, it seems to me that if we are serious about transparency, if we are

serious about accountability, you have to put a little bit more of a burden upon the lender.

Mr. Himpler, I would make the point that you made about the legal profession but turn it in a slightly different direction. I agree when a client would come to me when I was practicing law they don't know much about the Federal criminal statutes or title 7 or any of those things. It is my duty to give them my best and most searching judgment, and to provide good representation, I had a duty to ask them a lot of questions. I had to be intrusive. I had to ask them more than they told me.

Those who are in the realm of practicing law, if you are bound by what your clients tell you, you will commit malpractice a lot of times. You have to step beyond that. You have to know what questions to ask. You have to know how to drive your point home.

That is my concern, that there is a little bit of a sense of, well, if I am a lender, I am not going to cheat anybody, but nor am I going to ask them a whole lot of questions. I will let them tell me, and I will take what they tell me and structure my advice around it.

I submit to you if doctors followed that standard and lawyers followed that standard, the quality of care in both of those professions would dramatically erode.

Mr. Ernst, I will let you get the last word.

Mr. ERNST. I think—Congressman Davis, I think you are right, that this is an area where the suitability standard makes sense. There are direct parallels between the legal and medical profession.

Moreover, I think this is an area where it is actually unfair to expect the market to unilaterally take steps without leadership from policymakers. If a given lender tries to rein in broker behavior on their own, this broker would simply take their business elsewhere.

That is why it is important as we consider—I know it is under consideration—what Federal predatory lending standards can be, that those standards really help consumers, help lenders rein in instances where discretionary pricing—and this gets back to a question that was asked by Congressman Price—where discretionary pricing is leading to bad outcomes of the sort we have documented in our study where we find that there are still significant differences with African American or Latino borrowers being 30 percent more likely to be in a higher rate loan, even after we control objective risk factors like loan evaluation.

There has to be assistance from policymakers working in partnership with consumer groups, with housing counselors, and with lenders to solve these problems, that is something that is before you now.

Mr. DAVIS. Mr. Ernst, have we adequately publicized offending companies or offending brokers? Do we do a good enough job as an economy of publicizing bad actors?

Mr. ERNST. I think it may be possible that more could be done there, but I would say that there are simply so many lenders and so many mortgage brokers in the marketplace today that even providing that information is a real challenge.

I know in North Carolina our banking commissioner has talked about how in the past brokers have been able to set up shop under

a different name, and it is very difficult for consumers to weed their way through all of that information to find that sort of best seal of approval that I think you are suggesting.

Mr. DUNCAN. If I could, before we have leave the subject, since this very recent CRL study is coming up repeatedly, I want to refer back to the professor's statement about the ultimate efficacy about some of these pieces of research without full information. A couple of things to make note about that study is, for example, if you intend for the model in the study to replicate the lender's behavior, then you have to replicate what it is lenders look at in terms of the data to reach their decision.

One of the things that is in the study is the use of income. In fact, lenders do not use income. Lenders use the debt-to-income ratio both in the sense of the size of the potential mortgage payment to the other credit service payments and the size of the overall debt relative to overall income. Because what the lender is really interested is in the credit capacity of that borrower, as opposed to the specific income.

For example, you could have a very high-income household who also has very high levels of debt and is therefore a bad credit risk. You could have a very low-income household who has very low levels of debt and therefore could be a good credit risk.

Mr. DAVIS. Dr. Duncan, let me ask you this fairly pointed question. How much actual discrimination—how much actual race discrimination do you think goes on in the industry today?

Mr. DUNCAN. I think we would be naive to say zero. I think you are hard pressed to find expansive data of systematic discrimination. In between the two of those, I do not know what the number is.

Mr. DAVIS. Ms. Bowdler, do you want to answer the same question?

Ms. BOWDLER. I think I would echo that we would be hard pressed to come up with an exact percentage, but saying that there is not systemic discrimination is not right. We know that the structure of the mortgage market does channel harder-to-serve borrowers, which usually includes Latinos, African Americans, low income, other minority communities, and the elderly, and I think that is discrimination, and we should be concerned about that.

Mr. ERNST. If I might, since our study has been brought up—and, Doug, I appreciate you giving me the opportunity to clarify this here.

In our model, we control for the objective determinants of loan pricing. We did this by going out and looking, taking a survey of lenders' rates and saying what factors determine how your price is set in the market. What we saw in those sheets is that debt-to-income was the criteria for qualifying for a mortgage and, in fact, did not affect how mortgages are placed in the subprime markets. In other words, you can make the decision whether or not the borrower can pay back a loan overall, but we did not see this factor being used as a pricing factor, and that, quite simply, is why it is not included in our model.

I think the second point you raised is an interesting one. To look at lenders' behavior, we need to replicate exactly what they do in the underwriting process, and we have had a number of comments

here today about how no data source can allow you to do that. I think that is a fair remark, but I would say that what we sought to do was not to replicate lender behavior, but to understand what borrowers' experiences were in the marketplace.

So the strength of our study is that we are able to say, after we account for businesses between credit scores, between down payment sizes, we are able to talk about how borrowers' experiences differ based on their race and ethnicity.

So this is very different from the study that sets out to ask if lender "X", lender "Y" or lender "Z" is committing discrimination. That is not something that we set out to do. We set out to ask what borrowers' experiences are at the end of the day. Are borrowers more likely to receive a higher rate loan even after we are able to control for the differences in their credit score and the other factors that are used to set prices? And, unfortunately, the answer is that race and ethnicity still continue to have an effect.

Mr. WATT. Mr. Chairman, since we were getting into a debate about the Center for Responsible Lending's study, let me make a unanimous consent request that the study itself be submitted for the record, and everybody will be able to evaluate it on its merits or lack thereof, depending on their perspectives.

Chairman BACHUS. [presiding] Without objection.

I think at this point we have finalized the questioning, and the Chair notes that some members may have additional questions for this panel, which may be submitted in writing.

Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record.

Thank you for your attendance.

This hearing is adjourned.

[Whereupon, at 2:17 p.m., the subcommittee was adjourned.]

A P P E N D I X

June 13, 2006

STATEMENT OF CHAIRMAN SPENCER BACHUS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
"HOME MORTGAGE DISCLOSURE ACT: NEWLY COLLECTED DATA AND WHAT IT MEANS"

Good morning. The subcommittee will come to order. Today's hearing, which was requested by Ranking Members Frank and Sanders, Congresswomen Waters and Lee and Congressman Watt, will focus on the recently implemented Federal Reserve Board regulation under the Home Mortgage Disclosure Act that requires mortgage lenders to collect, report and make public new mortgage pricing data and what this data means to consumers and lenders. The possibility of racial discrimination in the mortgage industry is a serious issue that deserves our attention, and I am hopeful that today's hearing will shed some light on the issue. Owning a home is part of the American dream, and all Americans should be treated fairly when they try to make that dream a reality.

The Home Mortgage Disclosure Act (HMDA) was enacted by Congress in 1975 to provide the public with information to determine whether lenders are serving their communities, to enhance enforcement of laws prohibiting discrimination in lending, and to provide private investors and public agencies with information to guide investments in housing. HMDA, which is implemented by the Federal Reserve Board, requires most mortgage lenders located in metropolitan areas to collect data about their housing-related lending activity, report the data annually to the government, and make the data publicly available.

In 2002, the Federal Reserve Board required additional information to be reported for its 2004 HMDA data collection in order to improve the

quality, consistency, and utility of the data reported. Most importantly for high cost loans, lenders must now disclose pricing, which includes interest rates and fees, for higher priced loans. Other newly required information now being reported includes whether the loan is a first lien, a junior lien, or unsecured; whether it is secured by a manufactured home; and whether it is subject to the protections of the Home Ownership Equity Protection Act (HOEPA).

However, it should be pointed out that HMDA data does not include or take into consideration certain risk-evaluation factors used by lenders in determining whether to make a loan and at what price. Specifically, HMDA data does not include: the borrower's asset level or credit scores; the loan-to-value ratio of the property; the borrower's debt-to-income ratio; or the level of documentation submitted. Because of the limitations of HMDA data, I along with many Members of this Subcommittee signed a letter requesting that the Federal Reserve examine more comprehensive data to assess the extent to which loan pricing is correlated with risk. With this enhanced data, HUD, the Federal Reserve and Department of Justice should be able to make a determination as to whether any disparity in loan pricing is based on discrimination or risk-based pricing.

Today's hearing will consist on two panels. First we will hear from Federal Reserve Board Governor Mark W. Olson. On the second panel we will hear from Dr. Douglas G. Duncan, Senior Vice President and Chief Economist, Research and Business Development, Mortgage Bankers Association; Ms. Janis Bowdler, Housing Policy Analyst, National Council of La Raza; Mr. Bill Himpler, Executive Vice President, Federal Affairs, American Financial Services Association; Mr. Keith Ernst, Senior Policy

Counsel, Center for Responsible Lending; Mr. Calvin Bradford, President, Calvin Bradford & Associates, Ltd., on behalf of the National Fair Housing Alliance; and Dr. Michael E. Staten, Director, Credit Research Center, McDonough School of Business, Georgetown University. I look forward to hearing from today's witnesses and thank them for taking time from their busy schedules to join us.

In closing, I would like to thank Ranking Members Frank and Sanders and their staffs for working with us on this hearing. They are strongly committed to these issues, and I admire their efforts in ensuring that lenders comply with fair lending laws and that discrimination does not occur in the marketplace. I also believe that violations of our fair lending laws should not be tolerated and look forward to working with them and Members of this subcommittee as we continue to examine HMDA and predatory lending practices.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement that he would like to make.

STATEMENT OF THE HONORABLE WM. LACY CLAY
Before
The Subcommittee on Financial Institutions and Consumer Credit
"Home Mortgage Disclosure Act: Newly Collected Data and What t Means"
June 13, 2006

Good morning Chairman Bachus, Ranking Member Kanjorski, Members of the Committee and witnesses. Thank you for holding this hearing, Mr. Chairman.

The Home Mortgage Disclosure Act (HMDA) is an important tool for my district and for most districts that are in metropolitan areas. The data reported under HMDA includes information about denied home loan applications, race, sex and income of the borrower. Additionally, lenders have to report all first mortgages priced three percentage points above comparable Treasury yield and all secondary mortgages 5 percentage points over Treasury yield. We need this tool in my district to combat predatory lending, discrimination in lending and many other ills associated with obtaining affordable housing.

I was disturbed when proposals were made to eliminate the requirement that intermediate small banks collect and disseminate CRA data on small business, small farm and community development lending. The elimination of this data will eliminate the ability by which communities, for themselves, measure whether the bank is meeting the small business and farm needs of the community. There are no adequate substitutes for this data.

I understand that financial institutions have concerns about the costs and efforts required to produce and disseminate the data. However, the value of the data to our districts far outweigh the costs associated with its collection.

I am eager to hear what our panelists have to say on these issues.

I yield back the balance of my time, Mr. Chairman.

For release on delivery
10:00 a.m. EDT
June 13, 2006

Statement of

Mark W. Olson

Member

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

U.S. House of Representatives

June 13, 2006

Chairman Bachus, Representative Sanders, and members of the subcommittee, I am pleased to be here to discuss the uses and significance of the home loan data that are collected, reported, and publicly disclosed under the Home Mortgage Disclosure Act.

The act, which I will refer to as HMDA, was enacted over thirty years ago. Since then, it has undergone major changes. Today, HMDA requires most home lenders, a substantial majority of the home loan market, to disclose selected information about the applications they receive and the loans they extend each year. This information can be used for at least three purposes: first, to help the public judge how well lenders are meeting the housing-credit needs of their communities; second, to facilitate efficient investment in housing and neighborhoods; and third, to enhance the enforcement of laws prohibiting discrimination in lending.

HMDA promotes these goals through disclosure rather than substantive mandates or restrictions. The act does not direct lenders to make loans to any particular areas or persons. Nor does it direct lenders to make particular kinds of loans or to refrain from any particular loan terms or practices.

Instead, HMDA prescribes lender disclosures that, taken together, form a public data set about lending patterns. Every reportable application for a loan occupies a unique line in the data set. In 2005, there were approximately 31 million reported loan applications. The information disclosed about each application includes the race, ethnicity, and income of the applicant, the type and amount of the loan applied for, whether the loan was originated or the application was denied, and the census tract of the property to be financed. For the public's convenience, summary reports of the data are published by metropolitan area and by institution--for almost 9,000 depository and nondepository institutions. These summary reports are compiled by the Federal Reserve Board on behalf of the agency members of the Federal Financial Institutions

Examination Council (FFIEC). The Board also processes and edits the transaction-level data, which the FFIEC makes available to members of the public, who may analyze and compile the data as they see fit.

The information disclosed under HMDA constitutes a rich data set, but, of course, all data sets have their limitations. The HMDA data tell a great deal about lending patterns, but they do not tell the entire story. Nonetheless, by drawing attention to lending patterns, the data prompt discussion, investigation, analysis, and research that may deepen our understanding of why these patterns occur and allow us to increase fairness and efficiency in the home loan market. For example, in 1991, congressional amendments to HMDA resulted in the disclosure of data that, for the first time, revealed black and Hispanic applicants for mortgage loans were far more likely than non-Hispanic white applicants to have their applications denied. The publication of those data precipitated an important public discussion about the underlying causes--and about whether unlawful discrimination was one of the causes. That discussion helped bring about new initiatives for compliance and community development. Many lenders improved their lending policies and developed strong compliance and oversight programs. Lenders also expanded their outreach to underserved communities, often by strengthening ties with community-based organizations. The data also prompted supervisory and enforcement agencies to improve their fair lending oversight programs. In short, though denial disparities have persisted, HMDA's disclosure of those disparities has helped to increase the fairness and efficiency of the home loan market.

Last year we passed another HMDA milestone when the first loan-level information about mortgage loan prices was released. The public discussion that the release of these data has prompted is reminiscent of the discussion that took place after the initial release of loan-denial

data fifteen years ago. Today, the focus of the discussion has shifted from *which consumers* get home loans to *the terms* on which consumers get home loans--but the essential concern about the possible role of illegal discrimination is the same. I believe that the current public discussion about the new data will ultimately further the goals of fairness and efficiency in the mortgage market by prompting additional research, enhanced compliance and enforcement efforts, and more-effective investment in community development and financial literacy.

The Federal Reserve has responsibilities that relate to each of these areas. In my testimony today, I will discuss four roles of the Federal Reserve that relate to the HMDA data. First, the Federal Reserve Board was entrusted by Congress to write implementing rules for HMDA. Acting in that capacity, the Board required lenders to report loan-price data. Second, as a supervisor of financial institutions, the Federal Reserve uses HMDA data, including the price data, to facilitate its supervision of institutions for compliance with laws prohibiting discrimination in home lending. Third, as a research institution, the Federal Reserve conducts and publishes analyses of the price data, and it encourages research by other parties as well. Fourth, the Federal Reserve supports efforts by other organizations to use the HMDA data to identify financial education and community development needs. The Federal Reserve also supports their efforts to respond to those needs.

The Board's Decision to Collect Price Information

As I have said, it is a Board regulation, adopted under authority of HMDA, that requires lenders to disclose loan-price data. I will now provide some background on the Board's decision to amend that regulation to include price data. Advances in information processing technology have expanded access to credit and homeownership opportunities for consumers. In the past, individuals seeking credit to purchase a home, or seeking to borrow for some other reason, either

did or did not meet the specific underwriting criteria for a particular loan product; if they did, everyone paid about the same price for that product. Today, in part because of advances in credit scoring and underwriting technology, lenders can price loans according to risk, charging different borrowers different prices on the basis of a borrower's estimated creditworthiness.

The enhanced ability of lenders to assess credit risk gave rise to a segment of the mortgage market often referred to as subprime lending. In the subprime market, higher-risk borrowers pay higher prices. Subprime lending has grown rapidly, from less than 5 percent of all mortgage lending in 1994 to an estimated 20 percent in 2005, or over $600 billion. The wider range of loan pricing available in the subprime market helped to expand consumers' homeownership opportunities and to increase their access to home equity. But this same price variability has raised concerns about unequal treatment of borrowers. It also has raised concerns about whether certain loan terms and lending practices are appropriate, whether consumers have the ability and knowledge to shop for the most beneficial loan terms, and whether the subprime market is sufficiently competitive.

The Board responded to these concerns by amending Regulation C, the regulation that implements HMDA, to expand the available data on higher-priced lending. The data released by the FFIEC in September 2005, which covered lending activity in 2004, contained the first loan-level information on loan pricing ever available to the general public. The data contain price information for loans whose prices exceeded thresholds set by the Board. The thresholds were selected to target segments of the home loan market that have raised the most concern, taking into consideration the cost and burden of reporting. The thresholds generally correspond to an unofficial line separating the prime and subprime markets. But that line of separation is not always clear, and its correspondence with the reporting thresholds is in any event imprecise.

Therefore, we call loans whose prices exceed the reporting threshold "higher-priced loans" rather than "subprime loans."

This is only the second year in which price data will be publicly available under the Board's regulation. The Board continues to monitor the effects of the regulation in an effort to understand both its benefits and costs.

The Federal Reserve's Use of HMDA Data in Fair Lending Supervision

I have spoken of the Federal Reserve's role as the agency charged with implementing HMDA through regulations. The Federal Reserve also has a role as a supervisor of bank holding companies and state-chartered banks that are members of the Federal Reserve System. In that role, the Federal Reserve has long used HMDA data to help it supervise financial institutions' compliance with fair lending laws. The new data on higher-priced loans are yet another "screen" to make our fair lending supervision more effective. The Federal Reserve also shared analyses of the 2004 price data with other supervisory and enforcement agencies to assist them with their oversight of the institutions they supervise.

Before I discuss how the HMDA screen fits into the process of fair lending supervision, I want to describe that process more generally. Fair lending reviews are an integral part of the Federal Reserve's supervision for consumer compliance and are performed regularly within each examination cycle. In addition, examiners may conduct targeted fair lending reviews whenever circumstances warrant. Moreover, the Federal Reserve examines institutions' compliance with fair lending laws regardless of whether they report price data under HMDA. Indeed, the Federal Reserve was examining for potential price discrimination well before it adopted the HMDA price-reporting requirement. Although price reporting under HMDA is limited to higher-priced loans, examiners look for unlawful price discrimination at any pricing level. Furthermore,

examiners seek to detect other forms of discrimination, such as underwriting discrimination (for example, denying credit on the basis of the applicant's race) or redlining (for example, denying credit on the basis of the racial characteristics of the applicant's neighborhood).

Federal Reserve examiners use an institution's HMDA data, including its accept-deny data for loan applications and any price data it may have reported on originations, in conjunction with other information about the institution to determine the focus of the institution's fair lending examination. The HMDA data are incorporated into statistical management systems that produce analyses of lending patterns that aid the examination process. Starting in 2005, these analyses incorporated loan-price data. Other information that examiners use includes consumer complaints, the likely risks of an institution's different business lines, and the adequacy of the institution's compliance-risk management system. To gauge the risk of price discrimination, examiners consider, among other types of information, the presence of broad employee or broker discretion in pricing and the relationship, if any, between pricing and the compensation of loan officers or brokers. When examiners determine that a fair lending examination should focus on pricing, they collect additional information from the institution to evaluate whether pricing disparities can be fully attributed to legitimate factors or whether they are due, even in part, to unlawful discrimination.

If unlawful discrimination is found, the institution is referred to the Department of Justice or the Department of Housing and Urban Development, as required by law. Depending on the outcome of the referral and the nature of the violation, the Federal Reserve may also take other action to fully resolve the matter. For example, the Federal Reserve may direct the institution to provide remedies to harmed parties and improve its fair lending compliance controls and policies.

As the Federal Reserve has stated repeatedly, using the price and other HMDA data effectively in the supervisory process depends on a full understanding of the inherent limitations of those data. The HMDA data include valuable information, such as applicant or borrower income, loan amount, and the location of the property to be financed, but the data do not include many factors that lenders routinely consider in loan underwriting and pricing. Some of the typical credit-risk factors not included in the HMDA data are credit scores and loan-to-value ratios. Because the HMDA data lack such information, we cannot conclude from the HMDA data alone that an observed racial or ethnic difference in the prices of loans is the result of unlawful discrimination. That is why Federal Reserve examiners consider additional information about a lender, including information about its loan products and lending practices and its borrowers' creditworthiness, before drawing conclusions about the lender's compliance record.

In addition to improving fair lending supervision and enforcement by government agencies, the new pricing data have spurred institutions to improve their own compliance. Although examiners have long considered institutions' mortgage pricing as part of the fair lending review process, public disclosure of this pricing data appears to have given additional impetus to institutions' compliance efforts. Many institutions have reexamined their pricing policies and procedures to ensure that they do not permit, even inadvertently, pricing differences that violate the fair lending laws. Many institutions have also reevaluated their controls to ensure that proper policies are followed. This increased attention by institutions to their own fair lending compliance is one of the principal benefits of HMDA.

Research by Federal Reserve Staff and Others

Supervision for fair lending compliance deals with lending patterns at the institution level. But the HMDA data also reveal lending patterns at aggregate levels, across institutions.

Disclosure of aggregate patterns can raise and focus attention on important policy questions concerning access to credit. To that end, researchers at the Federal Reserve have published numerous papers and articles. Most recently, staff published an article about patterns in the new loan-pricing data.[1] I will review a few of their findings.

First, most home lenders make few, if any, higher-priced loans. In 2004, only about 500 out of the 8,850 reporting institutions made 100 or more higher-priced loans; the ten lenders with the largest volume of higher-priced loans accounted for about 40 percent of all such loans. (The FFIEC has not finished reviewing, processing, and editing the 2005 data, which were submitted in March of this year.)

The 2004 data also show that 16 percent of borrowers took out higher-priced loans that year in the nation as a whole. This proportion may have increased from 2004 to 2005. For most loans, the Board's regulation uses long-term interest rates to set the thresholds for reporting loan-price data, but mortgage loan rates more closely track short-term rates. Thus, a narrowing of the difference between short-term and long-term rates, such as occurred from 2004 to 2005, may increase the proportion of loans reported as higher-priced loans.

The proportion of borrowers obtaining higher-priced loans is not geographically uniform but varies widely by region and by city. For example, in many of the metropolitan areas of the South and the Southwest, 30 percent to 40 percent of homebuyers taking out conventional loans in 2004 took out higher-priced loans. In other areas of the country, the proportion was much smaller. These differences may not be that surprising--other data show that credit scores tend to be lower on average in the South and the Southwest than elsewhere--but they may nonetheless warrant further analysis.

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[1] Robert B. Avery, Glenn B. Canner, and Robert E. Cook (2005), "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin*, vol. 91 (Summer 2005), pp. 344-394.

Of course, public attention has focused on a notable variation in the incidence of higher-priced lending across racial and ethnic lines: blacks and Hispanics are much more likely than non-Hispanic whites to receive higher-priced loans. In 2004, 32 percent of black borrowers and 20 percent of Hispanic borrowers received higher-priced home purchase loans, but only 9 percent of non-Hispanic white borrowers did. In other words, black homebuyers received higher-priced loans more than three times as often as non-Hispanic white homebuyers, and Hispanic homebuyers received higher-priced loans more than twice as often as non-Hispanic whites.

Certainly, differences of this magnitude are disturbing and raise important public policy questions. They also have led some to conclude that racial discrimination must play a role in the pricing of home loans. However, for the reasons I have explained above, we cannot use HMDA data alone to judge whether an institution has discriminated unlawfully or, therefore, whether unlawful discrimination is present in the market.

Despite their limitations, the HMDA data supply a key insight into the aggregate disparities: they reflect in part a segmentation of the market by race and ethnicity. Black and Hispanic borrowers are more likely to obtain mortgage loans from institutions that tend to specialize in subprime lending. Now, at least part of this segmentation of the market by race and ethnicity may reflect objective differences in borrowers' preferences or differences in credit-risk indicators, such as credit scores, that are not included in the HMDA data. Yet the segmentation may have more troubling causes, at least in part. Segmentation may stem from borrowers being steered to lenders that charge higher prices than what is warranted by the credit characteristics of these borrowers. Borrowers may also have different levels of financial literacy, or their knowledge of the mortgage lending process may be uneven--for example, they may not

understand the importance of shopping and negotiating for the best loan terms. Additional research is needed to explore all of these, and perhaps other, hypotheses.

The Board will continue to conduct and promote research that explores the racial and ethnic differences in the incidence of higher-priced lending. In June and July, the Board is conducting hearings on the home equity lending market. These hearings, which I am chairing, are intended to gather information about, among other things, how consumers select their lenders and loans. The Board's 2007 biennial community development research conference will also provide a forum for research that may help explain differences in the incidence of higher-priced lending.

The Federal Reserve's Promotion of Community Development and Financial Literacy

I have discussed the Federal Reserve's roles in regulation, supervision, and research. Now I will turn to its role in promoting community development and financial literacy. The Federal Reserve System uses HMDA data to help banks, community organizations, and other interested groups identify community development needs and opportunities. For example, the Federal Reserve Bank of Boston tabulates HMDA data for the New England region to help regional financial institutions, community organizations, and state and local governments access and use information about their area's regional lending patterns. In addition, the Community Affairs Offices of the Federal Reserve System encourage and facilitate collaboration among financial institutions, governments, and community organizations to improve access to mortgage credit in traditionally underserved communities.

The Federal Reserve also promotes financial literacy. Board staff provide strategic advice on developing financial literacy policies, programs, partnerships, and marketing to national initiatives, such as the Jump$tart Coalition, Operation HOPE, and the DollarWi$e

Campaign of the Conference of Mayors. In a parallel effort, the Federal Reserve Banks support similar regional initiatives. The Federal Reserve also collaborates with other groups on research to develop successful financial education programs and identify the most effective way to deliver these programs to intended audiences. By these and other means, the Federal Reserve seeks to address gaps in consumers' understanding of not only home loan transactions but also financial management more broadly. These gaps in consumer understanding may be contributing to disparities in the availability and price of home loans.

In closing, I appreciate this opportunity to discuss the Federal Reserve's regulation requiring lenders to disclose price and other data on home loans; how the Federal Reserve uses the data to improve fair lending supervision; and the Federal Reserve's promotion of research, community development, and financial literacy.

Statement of

Douglas Duncan

Senior Vice President for Research and Business Development and Chief Economist

Mortgage Bankers Association

Before the

Subcommittee on Financial Institutions and Consumer Credit

Of the

House of Representatives Committee on Financial Services

On

June 13, 2006

Good Morning Chairman Bachus, Ranking Member Maloney and Members of the Subcommittee.

Introduction

My name is Doug Duncan and I am Senior Vice President for Research and Business Development and Chief Economist for the Mortgage Bankers Association (MBA).[1] I appreciate the opportunity to participate on this panel this morning to discuss what the new data gathered under the Home Mortgage Disclosure Act (HMDA) means, a topic that is of particular importance to MBA, its members and the mortgage industry.

The HMDA data comprise a unique and comprehensive set of loan-level data concerning most of the mortgage applications, dispositions of applications and originations of mortgages in the Nation. Congress intended that these data be collected and reported so that financial regulators and the public could monitor the performance of lenders in serving the credit needs of their communities, so that public and private entities can better consider their investment activities in these areas and, as necessary, to assist agencies in enforcing the fair lending laws.

Because of its centrality, breadth and relevance to the real estate finance industry, we at MBA continuously study the HMDA data. Indeed, I have been analyzing HMDA data from the day I joined MBA 14 years ago. I have watched the data set change, and, as a result of increased requirements, grow dramatically. Just in the last two years, the data set has measurably grown to encompass the rate related data on certain higher rate mortgages as well as other new data that we will discuss today.

MBA uses HMDA data to assist its members in analyzing the industry's performance in serving the nation and identifying new markets and investment opportunities. MBA's work helps members enter these markets and develop products and underwriting tools that appropriately take into account risk factors, including credit quality, to assure that the flow of finance reaches the widest number of borrowers possible while also assuring safe and sound lending.

The most recent HMDA data on loans made in 2004 and 2005 demonstrate the greatest and widest availability of mortgage finance in our Nation's history which, in turn, has made possible record homeownership rates. The data show that borrowers in virtually every area of the Nation, of every race and ethnicity, and at every income level receive an array of credit opportunities as HMDA was intended to display.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field.

Because of the success of the industry in addressing the Nation's credit needs, particularly those of previously underserved borrowers, the debate today has largely shifted away from concerns about the availability of credit. Now the discussion concerns whether the comparative prices of credit are fair across the spectrum of borrowers.

Sadly though, from some quarters because of the industry's success in serving borrowers at all credit levels, we face criticism. Lending to consumers today is a difficult proposition. If lenders deny a loan, particularly if it is a request from a lower-income or minority borrower, they risk being charged with redlining, or falling short on CRA requirements. If they approve a request, they risk charges of unsuitability or an unsafe and unsound credit decision. If they charge too much, they may stand accused of predatory lending. If they charge too little, they could be out of business. At this point, attorneys are telling businessmen what their business practices should be.

With regard to the new pricing data, beginning in 2004, lenders were required to report the "rate spread" or difference between the APR of a mortgage and the rate of a Treasury security of comparable term in those cases where the spread met or exceeded 3 % for a first mortgage or 5 % for a subordinate-lien mortgage.

The Federal Financial Institutions Examination Council (FFIEC)[2] regarded the new data to be collected for 2004 as so significant that the Federal Reserve published questions and answers to advise the public about the new rules (Questions and Answers) [3] and then at the time of its release published an extensive article accompanying the data release authored by Federal Reserve staff (hereinafter the 2005 Fed Report).[4] The FFIEC made clear that the HMDA data was not a basis for making definitive conclusions about discrimination but could provide signals for further regulator review where further scrutiny was warranted.

The 2004 HMDA data did show higher denial rates and a greater incidence of spread loans among some African American and Hispanic borrowers as compared to other borrowers. But these differences are explicable given an understanding of how mortgage loans are priced. Indeed, the 2005 Fed Report made clear that the Federal

[2] The Federal Financial Institutions Examination Council, established under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS). By law, FFIEC is also charged with facilitating public access to data that depository institutions must disclose under HMDA and the aggregation of annual HMDA data, by census tract, for each metropolitan statistical area (MSA).

[3] Federal Financial Institutions Examination Council, Frequently Asked Questions About the New HMDA Data (April 3, 2005).

[4] Robert Avery and Glenn Canner, *New Information Reported under HMDA and Its Application in Fair Lending Enforcement*, Federal Reserve Bulletin, Summer 2005, at 344-394.

Reserve's own analysis found that nearly 2/3 of the differences could be explained using HMDA data such as the income of the borrower along with data on the lender chosen. The 2005 Fed Report also indicated that the remaining differences may be explained by non-public pricing factors.

As the 2005 Fed Report pointed out, several factors impact the mortgage rate that a particular borrower receives. Most important is the overall level of interest rates in the economy. The traditional benchmark for the 30-year fixed mortgage rate has been the 10-year Treasury rate.[5] (The 10-year Treasury rate reflects the risk-free credit of the United State government. The 10-year also cannot be called; investors can expect to receive the stated interest rate on their investment for the full 10 years.) Mortgages typically trade at a spread above Treasuries due to the fact that they bear both credit risk, the risk that a borrower may default, and prepayment risk, the risk to the investor that the borrower may refinance or move, thereby paying the loan off well ahead of its stated maturity.

Thus, the second factor in the price is a premium to account for a borrower's expected credit and prepayment risk. Subprime borrowers tend to have both a greater level of credit risk, i.e. higher expected levels of delinquency and default, as a result of their prior credit problems, and greater prepayment risk. The reason for the greater prepayment risk is that subprime borrowers frequently prepay their loan if their credit improves and they qualify for a lower rate. Objective risk factors including credit scores and other items from a borrower's credit report such as payment history on prior mortgages, loan-to-value ratios, debt-to-income ratios, and other underwriting variables are powerful predictors both of a borrower's likelihood to pay on their loan and their likelihood to refinance. It is illegal to include any racial, ethnic, or other such demographic variables in the pricing decision.

A third factor in the price is the amount of administrative expenses associated with the loan. Loan applications that take additional time for an originator to complete are more costly. Additionally, small loans are more expensive to originate from the point of view of the originator, as the fixed costs are spread over a smaller balance. Subprime loans tend to be significantly smaller on average relative to prime loans.

Typically, the price is arrived at using a statistical model which may be embedded in an automated underwriting system. There is no place for race in this modeling. Moreover, the use of automated underwriting for most borrowers allows lenders to concentrate their attention on helping borrowers with unique credit histories or other characteristics qualify for financing.

The final factor in the determination of a borrower's mortgage rate does depend to some degree on the borrower's actions. Borrowers who aggressively shop among more than one lender are likely to get a better rate than borrowers who visit only one lender or mortgage broker. Borrowers need to make the competitive marketplace work for them and help wring out any excesses in pricing through their efforts. The 2004 HMDA data showed more than 8,800 lenders who offered more than 100 loans over the course of the year. These lenders are competing for the business.

[5] In fact lenders use a variety of indices to determine their cost of funds and help price their loans including the LIBOR/swap index.

Beyond limited data to assess risk such as income, HMDA data do not contain any of these relevant loan pricing data such as: credit scores; down payments; degree of documentation; cash-out information; loan-to-(property) value (LTV) ratios and debt-to-income ratios (both front-end ratios comparing mortgage payments to income and back-end ratios – comparing total debt payments to total income). [6]The data also do not measure the degree that borrowers shop among the myriad originators available, a factor that is also highly relevant to the price of a loan. For these reasons, the current HMDA data set cannot be used to draw definitive conclusions about why a loan was refused or made at a particular rate.

Having said all of this, one thing that is very clear is that the mortgage markets are dynamic and so are the underwriting models. The variables used to measure risk change over time. There is no perfect model to underwrite all borrowers. Two lenders will evaluate the same borrower and come to different assessments regarding the risks of that borrower. Not all institutions are equally profitable – in fact, some fail as a result of taking not enough or too much risk. One thing is certain: a one-size-fits-all model imposed on the industry would stifle innovation with respect to the measurement and pricing of risk, and that would be to the detriment of consumers. The innovation in this industry has benefited borrowers and increased the supply of credit, ultimately resulting in a higher level of homeownership than otherwise would have been the case.

As I will explain today, notwithstanding, the data as they are currently constituted do an outstanding job of fulfilling HMDA's intended purposes. The data fairly present a picture of the industry's work, offering information to further effective investment and, where appropriate, they provide flags for further regulatory review. The data should not be augmented at this point but need to be carefully analyzed and digested. In this process, I cannot caution too much against the misuse and misinterpretation of the data which, if unabated, risks harming the vitality of the mortgage market and the consumers it serves.

My simple message is that the mortgage market works and the data demonstrate that fact. The market is serving more borrowers, who are benefiting today from unparalleled choices and competition resulting in lower prices and greater opportunities than ever before, to build the wealth and well being that homeownership brings to our families and communities. It must be permitted to continue to do so.

I. Background

A. History

HMDA originally was enacted in 1975 to provide data on the locations of properties financed to help stem perceived redlining and disinvestment in urban areas. The Federal Reserve implements the law under the HMDA rules known as Regulation C.

Since the law's enactment, Congress has amended and the Federal Reserve has extended HMDA's requirements to greatly expand the types of information that must be

[6] Historically, lenders employed 28% front-end and 36% back-end ratios in their underwriting. Today, as risk modeling has become much more sophisticated, there is greater flexibility in underwriting to qualified borrowers.

reported and disclosed, and to require that most lenders--depository and non-depository--report. By 2002, the data set included a very wide range of variables including: loan type and purpose; owner occupancy status; loan amount; loan action taken; date the action was taken; location of the property to which the loan applies by metropolitan statistical area (MSA), state, county and census tract; as well as the race, national origin, sex and gross income used by the applicant or borrower in requesting credit.

At the time HMDA was enacted, it covered depository institutions only. Now, all but the smallest lenders--including commercial banks, savings institutions, mortgage companies and credit unions--with offices in metropolitan statistical areas are required to report and disclose to the public data on applications for home loans and the home loans that they originate or purchase during each calendar year. 8,853 lenders reported last year. [7]

Each year, lenders are required to release the prior year's HMDA data to the public in unaggregated form as early as March 31 of the year following the data collection, in response to public requests. Later in the year, HMDA data are released in aggregated form for the preceding year by the FFIEC.

In 2002, for the stated purposes of improving the quality, consistency and utility of the HMDA data, as I have indicated, the Federal Reserve amended Regulation C to require the reporting of pricing data on non-prime loans including the difference or "spread" between a loan's annual percentage rate (APR) and the yield on a Treasury security having a comparable maturity - where the spread is at least 3% for a first-lien loan or 5% for a subordinate-lien loan. Under the 2002 changes, lenders are also required to report data on the lien status of the loan or application, e.g., first lien, subordinate-lien or not secured by a lien on a dwelling; whether the loan is subject to the Home Ownership and Equity Protection Act (HOEPA); whether the loan or application involves a manufactured home; and whether an application has been denied under a covered pre-approval program.

The Federal Reserve chose to collect the pricing data to study the borrowers and properties served by the non-prime market which generally serves borrowers whose credit may be blemished, who may bear a higher debt load, or present other increased risk factors. [8]

The new data were required to be reported for the first time in 2005 for 2004 loans; this year's data, which will be released by the FFIEC in aggregated form in September, reports on 2005 loans. Pricing data are reported along with all of the other data including race, gender and property location.

II. The 2004 Data Reported in 2005

[7] Banks that are exempt from HMDA reporting and Regulation C include institutions with less than $35 million in assets, are not in the home lending business or have offices exclusively in rural (nonmetropolitan) areas. Mortgage companies are required to report unless they extend less than 100 purchase or refinance loans a year or do not operate in at least one metropolitan area.

[8] Although useful, this reporting regimen is an imperfect measure of higher rate and non-prime lending. Spread loans do not include all higher rate loans or non-prime loans. As is noted in this testimony, the relationship of long and short term rates in any given year may affect how many loans are reported. So may other factors.

The 2004 data underscore the fact that HMDA provides useful information about the home loan process but will always require reference to non-HMDA data and other information to explain some pricing differences.

As indicated, the 2004 HMDA data showed higher denial rates and differences in the incidence of spread loans for minorities. The 2005 Fed Report points out, however, that after analyzing HMDA data, including borrower income and type of loan, 2/3 of these disparities were reduced. Moreover, after examining data provided by the Credit Research Center on a handful of lenders that included data extrinsic to HMDA data including credit scores, LTV and other risk factor data, the 2005 Fed Report pointed out that the remaining differences in denials and rates could be explained by data on credit scores and other risk related data.

Importantly, the Federal Reserve did not have access to risk factor data on most lenders at the time the 2005 Fed Report was issued. As a result of its analysis of the public HMDA data alone, the Federal Reserve forwarded a list of 200 lenders with statistically significant differences to banking regulatory agencies for further examination.

The regulators are reviewing these institutions' data and the process will go forward focusing on the risk related and other relevant information that lenders provide. Such review will consider the complex factors involved in loan decisions, exactly the type of analysis that will explain the pricing of loans.

Considering the factors used in pricing a loan, it can be anticipated that there will be sufficient justification for loan pricing based on credit differences and risk related factors.

In any case, pending the outcome of these reviews, no good is achieved by prejudging them. MBA shares the concern that was well articulated in the 2005 Fed Report that the misuse of HMDA data, focusing merely on differences in denial rates or the incidence of higher rate loans for certain borrowers, without considering relevant risk related and other factors, misstates the data and presents reputational risk to lenders and the very disinvestment that HMDA was intended to prevent.

III. The 2005 Data Being Reported in 2006

It is notable that for 2005, more loans are being reported as "spread loans" than for 2004. This is a function of the economic and interest rate conditions pertaining in 2005 as a result of a flattened "yield curve." For this reason, the Federal Reserve recently has cautioned that year-to-year changes in spread loan data must be interpreted with great care. [9]

Notwithstanding that "spreads" are required to be reported based on how they compare to Treasury securities of comparable terms, mortgages are priced based on their

[9] Question and Answer 29, Federal Financial Institutions Examination Council, Frequently Asked Questions About the New HMDA Data (April 3, 2005).

anticipated durations using shorter term obligations. The "yield curve" depicts the relationship between short and long term interest rates.

During 2005, the yield curve flattened as short-term rates increased to a greater extent than long term rates, resulting in an increased number and proportion of loans that were required to be reported.

In its recently published question and answer document, the Federal Reserve pointed out that this can occur even though the business practices of lenders and the risk profiles and borrowing practices of borrowers remain constant. Conversely, if short-term rates fall more than long-term rates, then the number and proportion of loans reported as higher-priced loans will fall if all other potentially influential factors remain constant.

While it is also possible that the number or proportion of loans reported as higher-priced could change in response to other factors such as business strategy or a general decline in borrower credit, the sheer number of possibilities also militate in favor of careful consideration of all relevant conditions to avoid drawing incorrect conclusions about the level of higher rate lending based on spread reporting alone.

Indeed, both the relatively recent inclusion of information on higher rate loans and this year's flat yield curve, and its effect on the numbers of higher rate loans reported argue strongly for judicious analysis of HMDA data and against hasty action while the industry, government and the public consider the new data.

IV. Reports by Advocates

Notwithstanding warnings against misuse of the data, since the pricing data first became available in early 2005, press releases and reports by advocacy organizations state that the differences in denials and higher rate lending among minorities are unfair and possibly discriminatory.

Most recently, the Center for Responsible Lending (CRL), a North Carolina based advocacy group, issued a press release and a report entitled *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*. The report, utilizing Home Mortgage Disclosure Act (HMDA) data spliced together with some risk factor data such as credit scores from a Loan Performance Data set, asserts that African-American and Hispanic borrowers are more likely to receive higher-rate non-prime home loans than white borrowers even after controlling for risk factors.

MBA is in the process of analyzing the CRL report and its assertions. Nevertheless, several concerns about the study's methodology are evident including that (1) the study was only able to match HMDA data and Loan Performance data for 177 thousand records out of a possible 5 million raising significant concerns whether the data set ultimately used was meaningful; (2) key risk factors such as debt-to-income ratios were not included in the analysis; and (3) where relevant factors such as the extent of borrower documentation were analyzed the analytical approach does not square with industry practice. At this stage in our review, we question whether the report's hypothesis is supported. To the contrary, we believe there are legitimate business reasons for price differences that militate against any claim of unfairness. The report's findings are contradicted by other research, notably the Federal Reserve's own analysis. Regrettably, past CRL reports including a study that the patchwork of state predatory

lending laws only resulted in costs of $1 per loan were deficient methodologically and otherwise have not been well-founded.[10]

It is notable that over the last several years the difference between the rates of prime borrowers and non-prime borrowers are decreasing or compressing. This compression has benefited borrowers in the non-prime market by providing rates that are closer to prime rates. The cause of this compression as well as the abundance of credit is the unparalleled number of loan originators that are competing for borrowers' business. These include mortgage companies, banks, credit unions and mortgage brokers.

Conversely, the misuse of data, for the purpose of pushing a particular agenda such as the enactment of the patchwork of state laws or overzealous national proposals, or otherwise, can be expected to hinder competition and stem the lowering of rates to borrowers.

V. The HMDA Data Set is Sufficient for its Purposes and Should Not Be Expanded

Considering HMDA's purposes, there are several compelling reasons why the HMDA data set should not be expanded to include an extensive set of risk factors. Such an approach is unnecessary. It would be unduly costly, jeopardize borrower privacy, potentially undermine proprietary interests; risk calcifying innovation to extend credit to an increased number of borrowers, and still lead to an incomplete data set for purposes of examining loan pricing.

As the 2005 Fed Report emphasized, the collection and reporting of data entails considerable costs which are ultimately borne by borrowers. Indeed, the Board chose to require the reporting of rate spreads on non-prime loans in lieu of other approaches to studying the non-prime market in the interests of minimizing these costs. Moreover, since the HMDA data comprise a public data set, as the 2005 Fed Report pointed out, were credit and other risk information made public in this era of data mining, borrowers' private information regarding their financial wherewithal would quickly be compromised using other data bases for a host of commercial ventures. Also, revealing risk factors may permit reverse engineering of underwriting models not only undermining proprietary systems but potentially inviting fraud. At the same time, identifying a finite set of risk factors would effectively wire these factors in, freezing innovation in an area that continues to develop newer and better credit models to extend credit to an increasing number of borrowers.

While HMDA data were intended to shed "sunshine" on lending activities and where necessary flag areas requiring further review, Congress never intended the data set to prove or disprove discrimination conclusively. In fact, regulators have access to all relevant data and information including all relevant risk information rendering it unnecessary to expand the public data base to contain such factors. Finally, since loan prices are also arrived at based on a borrowers willingness to shop and compare the myriad offerings in the marketplace, any expansion of the data set merely to include risk factors would be incomplete with respect to loan pricing.

VI. The Market Today

[10] Center for Responsible Lending, Strong Compliance Systems Support Profitable Lending While Reducing Predatory Practices, July, 2005.

The market for home mortgages has changed radically in recent years. Home prices have increased dramatically, presenting significant affordability challenges in many parts of the country, which the industry has responded to by providing flexible and affordable loan products. Largely as a result of increasingly sophisticated underwriting tools, risk based pricing permeates the industry. At the same time technology has improved underwriting and risk management capabilities enabling industry to better serve the needs of borrowers with less than perfect credit.

Homeownership is at near record levels, and it is increasing the most among minorities. The homeownership rate in 2005 was 68.9 %, the rate for African-Americans was 48.2% and for Hispanics 49.5%.

In the second half of 2005, according to MBA's Mortgage Originations Survey, prime loans accounted for 64%, non-prime loans 21%, Alt-A loans 12%, and government loans 2% of the dollar volume of first mortgage originations. In terms of outstanding loans, the non-prime and prime share has grown markedly in recent years as the government programs (FHA and VA) have lost significant share. According to MBA's data, at the end of 2005, prime loans accounted for 76%, non-prime 13%, and FHA and VA the remaining 11% of outstanding loans.

While the HMDA data demonstrate the abundance of credit, the data does not fully gauge the industry's extraordinary increase in products for both prime and non-prime borrowers. The data do to some extent demonstrate the growth of the non-prime market which in some measure is captured by the loan pricing data. Non-prime originations accounted for 21% of the market in 2005, up from closer to 5% a decade ago.

Foreclosures are greater in the non-prime market than in the prime market, but the numbers are far less than some have suggested. Let me start by noting the importance of market growth when interpreting delinquency and foreclosure numbers. According to HMDA data, in 2000, there were 8.3 million applications for mortgages to buy a home. In 2004, there were 9.8 million applications for purchase mortgages. When the market is growing, even if the foreclosure rate remains constant, there will be an increase in the number of foreclosures. However, too frequently some market analysts point to an increase in the number of foreclosures as a problem in and of itself, when it in fact it very well may reflect a constant or even declining foreclosure rate in the context of growing market making more families homeowners than ever.

In the fourth quarter of 2005, the non-prime market had a foreclosure rate of 3.3%. While this rate is greater than the prime market rate of 0.4%, non-prime borrowers by definition present greater risks of default than prime borrowers. Indeed, were there no difference in default rates, controlling for other factors, any mortgage rate difference between prime and non-prime borrowers would be questionable.

Compare these differences to the foreclosure inventory rate for subprime loans in 2001 peaking at 9%. The latest numbers tell a good story about lenders' ability to manage risk and the wherewithal of subprime borrowers. In any case, those who would fix on a relatively low foreclosure rate as a reason for over regulating the non-prime market risk denying the overwhelming majority of non-prime borrowers the prospect of homeownership.

VII. Conclusion

HMDA is working. It provides a rich data set concerning the availability of credit to meet its legislative and regulatory purposes. It well reflects activity in the marketplace, provides usable information to facilitate public and private investment, and effectively provides signals to regulators where further review is warranted

Rational analysis of the data and the marketplace suggests that denial rates and any differences in the incidence of minority and non-minority higher cost loans will prove explicable based on non-discriminatory factors. Absent overregulation and the imposition of unworkable solutions, the range of mortgage products and the "risk-based" pricing prevalent in the mortgage lending industry will continue to expand access to credit and continue to contribute to the highest levels of home ownership in American history. At the same time, competition will continue to compress rates in the non-prime market.

While rates are largely determined by risk factors, the effectiveness of borrower understanding and shopping to lower rates cannot be discounted. While mortgage markets are functioning well and serving consumers, borrowers find it challenging to understand the mortgage process. While an overhaul of our education system to make financial literacy a priority is a long term goal, MBA believes steps have to be taken in the short term.

MBA believes actions should be directed toward three areas to improve borrower understanding and help them get the best prices possible. First, borrowers have to be provided effective tools to educate themselves about the mortgage process. Second, consumers need simpler, more user friendly disclosures about mortgage loans in order to shop and compare. Third, consumers need to be urged to shop more intensely, comparing mortgage offerings from lender to lender.

MBA's research has shown that homebuyers, particularly first-time homebuyers, rely on a trusted advisor, who may have an adverse incentive, to help them through the complex process of buying a home and getting a mortgage. Too often, MBA believes, these new buyers, and particularly minority first-time homebuyers either contact only one lender or mortgage broker, or are referred by a real estate agent to only one lender or broker while shopping for a mortgage. Borrowers more experienced in the process are generally more likely to seek additional rate quotes.

MBA believes that borrowers need to educate themselves about the mortgage process – so much so that MBA created an educational website about the mortgage process for consumer use at www.HomeLoanLearningCenter.com. In addition, MBA is committed to working to put together a meaningful mortgage disclosure or disclosures that contains relevant, easily understood information that a consumer can use to shop and compare mortgage loans. MBA believes that armed with a basic understanding of the mortgage process, an ability to compare loans, and a willingness to shop, a consumer will be in a far better negotiating position when trying to get a competitive home loan.

Conversely, MBA opposes efforts to chill the innovation in our Nation's mortgage markets or in any way weaken the competition that has served the economy and American families so well. The market is working but it is not invincible. I would submit

that solutions that risk its vitality include unnecessarily burdening lenders with additional data requirements and continuing to expand the patchwork of laws at the state and local level aimed at predatory lending. There is a very real conflict between any potential benefits of state and local regulation of this sector of the economy, and the many benefits that have already been achieved through vigorous competition among lenders active in this sector. Additional restrictions impose a cost – they reduce the flow of credit to borrowers who would otherwise have access to it, by reducing the ability or willingness of at least some group of lenders to lend, reducing competition and its benefits.

Again, I appreciate the opportunity to testify and I look forward addressing your questions.

NCLR
NATIONAL COUNCIL OF LA RAZA

Home Mortgage Disclosure Act: Newly Collected Data and What it Means

Submitted to:

U.S. House of Representatives Committee on Financial Services
Subcommittee on Financial Institutions

Submitted by:

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June 13, 2006

Introduction

My name is Janis Bowdler, Housing Policy Analyst for the National Council of La Raza (NCLR). As part of NCLR's Economic Mobility Initiative, I conduct research, policy analysis, advocacy, and program assistance on affordable housing issues. Prior to coming to NCLR, I worked for a large community development corporation (CDC) in Cleveland, Ohio, as a Project Manager developing affordable housing. I am pleased to present our views for the hearing entitled, *Home Mortgage Disclosure Act: Newly Collected Data and What it Means.*

As you know, NCLR is a private, nonprofit, nonpartisan organization established in 1968 to reduce poverty and discrimination and improve opportunities for the nation's Hispanic families. As the largest national Hispanic civil rights and advocacy organization in the U.S., NCLR serves all Hispanic nationality groups in all regions of the country through a network of nearly 300 affiliate community-based organizations.

NCLR has a deep interest in increasing the rate at which Latinos own and build equity in their home and thereby accumulate wealth that will provide financial stability in the years to come. Over the past two decades, NCLR has been a leader in advocating and conducting research on affordable housing issues important to the Latino community. This work focuses on issues such as asset accumulation and barriers to homeownership, access to affordable mortgage products, and programs and legislation that support fair lending. NCLR's most recent relevant publications include *Hispanic Housing and Homeownership*; *American Dream to American Reality: Creating a Fair Housing System that Works for Latinos*; and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*. In addition, NCLR has provided expert testimony before Congress on these issues and, most recently, before the Board of Governors of the Federal Reserve.

Since 1997, NCLR has also been a national intermediary designated by the Department of Housing and Urban Development (HUD) to distribute funding for housing counseling services. The NCLR Homeownership Network (NHN) consists of 38 NCLR Affiliates in 21 states which provide pre-purchase bilingual homeownership counseling to low-income families in predominately Latino neighborhoods. NHN counsels more than 14,000 families each year, more than 2,500 of which become homeowners. NHN has sophisticated partnerships with some of the nation's largest providers of home mortgages such as Bank of America, Countrywide, JPMorgan Chase, Washington Mutual, Wells Fargo, Fannie Mae, and Freddie Mac. Our extensive research and service delivery experience gives us insight into how the homeownership market serves Latino borrowers.

The publication of the 2004 Home Mortgage Disclosure Act (HMDA) data has raised serious public policy concerns. For several years running, research organizations have documented overrepresentation of minorities in the subprime market. The release of the 2004 HMDA data revealed that minorities were also overrepresented in loans that met the Home Ownership and Equity Protection Act (HOEPA) rate spread, the most expensive subprime loans. In my testimony today, I will briefly explain what the HMDA reveals about Latino families' access to homeownership, the market forces driving the racial and ethnic lending disparities, and some limitations on how HMDA data can be used.

HMDA and Latino Homeownership

Like most Americans, the majority of Hispanic families rely on mortgage financing to purchase their home and build equity that will serve as their financial safety net in the future. Detailed information for the vast majority of such mortgages is made publicly available under the HMDA. HMDA data allows the public to evaluate the quantity of loans made available in their neighborhoods as well as judge certain qualitative aspects of those loans. In 2004, in response to a Federal Reserve mandate, information regarding the loan price for certain loans was added to the list of reportable variables. In addition, the classification of "Hispanic or Latino" was updated. The 2004 HMDA data created a new category of "Ethnicity" in which borrowers reported belonging to one of two categories: "Hispanic or Latino" or "Not Hispanic or Latino." In previous years, Hispanic had been an option under the race category. Since Hispanics can be of any race, the distinction between race and ethnicity is an important one, and it improves the quality of the data. NCLR uses the terms "Hispanic" and "Latino" interchangeably.

Broadly speaking, the mortgage market is divided between the prime market, which consists of mostly bank institutions who offer standard and affordable mortgage products, and the subprime market, which was created to serve credit-impaired borrowers. Recent research has documented the overrepresentation of minority families in the subprime market compared to White families.[1] All studies found that the disparity rises as incomes rise. This is certainly the case with Latino families. Latino families are nearly twice as likely as White families to receive a subprime loan. Middle- and upper-income (MUI) Latino families are 2.6 times as likely as MUI White families to receive a subprime loan. A review of the 2004 HMDA data by the Center for Responsible Lending revealed that Latino families are 30% more likely than Whites to receive the highest-cost subprime loans – those that meet the rate spread that triggers the protections of HOEPA – even after controlling for credit scores and loan-to-value ratios.[2] This disparity grew not only as incomes increased, but as credit scores increased.

NCLR's review of the data revealed that Latinos are more likely than Whites to be denied for loans and that subprime lenders take in a larger proportion of Hispanic loans than prime lenders do.[3] We have also had the opportunity to review proprietary HMDA data from select mortgage lenders. These reviews have revealed findings consistent with all previous findings: Latino families are overrepresented in the subprime market and are denied at higher rates than White families, even with credit scores comparable to those of Whites.

These disparities are a clear indicator that the market is not serving Latino families effectively. Having an over concentration of otherwise creditworthy families in the subprime market means disposable income is being misspent on interest and fees, rather than on building equity. In some cases, families pushed into the subprime market are the victims of abusive lending practices that

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[1] Bradford, Calvin. *Risk or Race?* Washington, DC: Center for Community Change, 2003; *Separate and Unequal: Predatory Lending in America,2004.* Washington, DC: ACORN, 2004; and *Homeownership and Wealth Building Impeded.* Washington, DC: NCRC, April 2006.

[2] *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages.* Washington, DC: Center for Responsible Lending, 2006.

[3] Bowdler, Janis. *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market.* Washington, DC: National Council of La Raza, 2005.

may result in foreclosure. Overall, communities are much better served by a well-functioning market that allows families equal access to credit and wealth-building opportunities.

Market Forces

The racial and ethnic disparities in the home lending market are not an accident. In the case of the Latino community, many Latino borrowers have underwriting variables that pose challenges to modern underwriting systems. For example, according to one study, 22% of Latinos have a "thin" credit file, or no credit history, which usually results in a "0" credit score, compared to only 4% of Whites.[4] In addition, verifying cash income and documenting employment history can also create challenges for some families. While mortgage prime products exist which use non-traditional credit and other flexible underwriting standards, they generally require manual underwriting that is time and resource intensive for the lender. In addition, loan officer compensation systems tend to make manually underwritten loans less attractive. NHN organizations only prequalify families to prime and FHA/VA loan products, and 88% of their families have incomes below 80% of Area Median Income (AMI), refuting the myth that low-income, nontraditional credit families cannot qualify for prime products. Rather, lenders are motivated to limit the credit made available via such flexible products because of the increased cost of underwriting a family with such barriers. These structural factors effectively bar many Latino families from obtaining prime mortgage financing.

Families that are unable to obtain affordable, flexible products in the prime market are routed to the subprime market. Not unlike the prime market, the subprime market is driven by profit motives that require efficiency and accuracy. However, the subprime market does not refer its "hard-to-serve" clients to another market. Rather, lenders in the subprime market rely on risk-based pricing models to price loans for any risk level. The criteria for gauging risk are discretionary, vary by lender, and are centered on making profits rather than the appropriateness of the loan to the consumer's financial situation. For a variety of reasons, Latinos and other minorities find themselves channeled toward the products most profitable to the lender, but which are expensive and risky for borrowers.

In an effort to further cut costs and increase profits, many subprime lenders rely heavily on their whole sale units, which – unlike retail branches – are little more than underwriting centers and relying on independent mortgage brokers to deliver their loans. Mortgage brokers serve as market intermediaries between lenders and consumers, and originate two-thirds of the nation's mortgages by most estimates. To lenders, market intermediaries promote themselves as a less expensive alternative to retail operations which also provide a greater reach into diverse markets. Consumers, especially Latinos, also rely on the services of mortgage brokers. Bilingual and bicultural brokers market themselves as agents who can be trusted to find consumers the best deal. However, discretionary Yield Spread Premiums (YSPs) offered by lenders provide further incentives for brokers to steer borrowers to products that are more profitable for themselves, rather than those most suitable to the client's needs. This problem is exacerbated by the rise of

[4] Stegman, M. "Automated Underwriting: Getting to Yes for More Low-Income Applicants." Presented before the 2001 Conference on Housing Opportunity, Research Institute for Housing America Center for Community Capitalism, University of North Carolina-Chapel Hill.

nontraditional mortgage products, such as interest-only loans, payment-option mortgages, and loans without documentation, where brokers are able to layer subjective pricing criteria to sell mortgage financing that is very high risk to consumers. Recent projections of a rise in foreclosure rates raise legitimate concerns that these products will have long-term consequences for the affected borrowers, communities, and investors.

In fact, many subprime lenders and mortgage brokers are outperforming the prime market in their service to Latino families. Both are more aggressive in marketing directly to Latino consumers via Spanish-language media. Their advertisements contain little information regarding the nature or risks of the products to the consumer, and many do not face competition from providers of standard mortgage products. Mortgage brokers in particular are diversifying their workforce, offering a wider range of products, and adopting a one-on-one style that makes Latino families feel comfortable.

The outcome of this can be seen in the highly-publicized racial and ethnic disparities in products and pricing. For example, new research shows that Latinos are 30% more likely to receive a high-cost loan (one that meets the rate-spread) than Whites when purchasing their home. Other research shows that alternative mortgage products such as Option Adjustable Rate Mortgages (ARMs) and interest-only mortgages are disproportionately concentrated among minority borrowers. Latinos are more than twice as likely as Whites to receive a payment option mortgage.

Limitations of HMDA Data

HMDA data provides advocates, public officials, and lenders critical information about the performance of the market and the distribution of services. However, more information is needed to complete the picture that the mortgage finance industry has created in arguing that market dynamics drive the racial and ethnic mortgage price disparities. In other words, they claim that minorities have riskier profiles; thus, there is nothing to be done about the fact that they receive higher-cost mortgages. However, the public has no way of testing this assertion using solely HMDA data. To make HMDA data more useful to all interested parties, more information is needed. For example, three key data fields missing from HMDA are loan-to-value ratio, debt-to-income ratio, and credit score. In addition, HMDA data should denote whether a mortgage broker was involved in the closing of a loan. These data would give us a clearer picture of the market dynamics between mortgage markets and stakeholders.

In addition, there are some barriers to public use of HMDA data. The general public accesses HMDA data in one of two ways. Researchers and others with sophisticated statistical software at their disposal (such as SAS or SPSS) are able to order the data and upload it into their software or mainframe application. Others are able to download information off the Federal Financial Institution Examination Council (FFIEC) website. Prior to the introduction of the 2004 HMDA data, users could download this information into Microsoft Excel, or similar software, which is much more widely used. Now, the data appear in PDF format, or Portable Document File. This makes it difficult for those that do not use statistical software to examine the information closely. Also, not all publicly available data appear on the website. For example, distinctions between subprime and prime lending institutions are not listed in the tables published on the Internet.

Another example, the data available on the Internet does not always allow the user to examine a lender's national portfolio, usually you must examine them one Metropolitan Statistical Area (MSA) at a time. Such obstacles inhibit the ability of smaller community-based organizations and public institutions from accessing and analyzing the HMDA data.

Conclusion

HMDA data is the principle tool for monitoring the mortgage lending market and the equity of loan distributions. Based on this data we know that Latino and other minority communities are overrepresented in the most expensive products of the subprime market. Deeper analysis of market forces suggests that this is a result of lenders pushing profit margins, rather than the availability of appropriate loan products. Minorities are not just overrepresented in subprime and expensive products, they are also more likely to receive the riskiest of products. And, finally, while the HMDA data has limitations that should be filled-out, it represents the most complete picture we have to gauge the performance of the mortgage market.

In closing, NCLR would like to make the following recommendations:

- **Hold lenders and mortgage brokers accountable.** Lawmakers and regulators should create and enforce a suitability standard with a strong anti-steering provision. Such a standard is necessary to neutralize industry-profit motivations that provide incentives for putting otherwise creditworthy families into expensive or risky loan products.

- **Remove the barriers to HMDA analysis.** To increase the functionality of HMDA, NCLR recommends adding several data fields, including loan pricing information for all loans, product type (30-year fixed, ARM, negatively amortizing, Interest-Only, Stated Income), loan-to-value ratios, and foreclosure information. In addition, data available on the Internet should be made more user-friendly by allowing information to be downloaded into Excel, adding prime and subprime distinctions to Internet tables, and allowing for national or multiple city analysis of lender-specific data.

- **Invest in housing counseling.** Housing counselors are effective market intermediaries that help low- and moderate-income families to access responsible and affordable mortgage products. For example, 88% of NHN clients are below 80% of Area Median Income (AMI) and many require manual underwriting, but all those who achieve homeownership through our network receive prime products. Public entities and private mortgage companies must invest in the infrastructure to ensure it is equipped to meet the demand for its services.

Testimony of Bill Himpler for the American Financial Services Association

Before

The Sub-committee on Financial Institutions and Consumer Credit of
The House of Representatives Financial Services Committee

June 13, 2006

Good morning, Chairman Bachus, Ranking Member Sanders and Members of the Subcommittee. My name is Bill Himpler and I am the Executive Vice President for Federal Affairs for American Financial Services Association located here in Washington, DC.

AFSA's 300 member companies include consumer and commercial finance companies, "captive" auto finance companies, credit card issuers, mortgage lenders and other financial service firms that lend to consumers and small businesses. This year, AFSA is celebrating its 90th birthday as the nation's premiere consumer and commercial credit association.

I am pleased to be here today to provide an industry perspective on the Home Mortgage Disclosure Act, also known as HMDA. Specifically, my comments will focus on the value and limitations of the data collected under HMDA, and why we think the 2004 data demonstrates that risked-based pricing works. But first, let me provide some quick background on this law.

When it was first enacted in 1975, HMDA's intent was to identify and prevent "redlining." Therefore, lenders were required to provide data on the location of loans financed by property location by state, county and census tract.

In 1989, HMDA was amended to require lenders to collect and report the race, sex, and income of every applicant and borrower. In 2002, HMDA was again amended to include rate information on higher rate loans. In 2004, lenders began reporting on the "spread," or difference, between the borrower's APR and comparable Treasuries.

While the HMDA data can assist regulators in several ways, they do not present a complete picture of the mortgage lending process. That's because the data do not contain relevant risk- and pricing-related information, including: 1) the borrower's credit score, 2) the Property type, 3) the Down payment, 4) Any Cash-out information, 5) the Property value, 6) the borrower's Debt-to-income ratio, 7) Loan-to-value ratio and 8) Assets. Marketplace competition and the degree of borrower research and comparison shopping also are among the factors that typically determine the rate received by the borrower.

Without the information I just listed, HMDA cannot be used to draw accurate conclusions about why a loan was refused or made at a particular rate. Throughout 2005, the Federal Reserve explicitly cautioned that using raw HMDA data alone could lead to faulty conclusions about lending practices.

The obvious question is: Why not require lenders to collect and report borrowers' credit and risk related information that is used to price a loan and determine the rate charged? There are several reasons.

First, the release of credit scores and certain other data would undermine the privacy interests of borrowers. Second, the data elements utilized by lenders are numerous and weighted differently by different lenders and such weighting cannot be disclosed without undermining market competition. Third, regulators already have the ability to review individual loan files, which is really the only way to determine whether lending discrimination has occurred.

Even if all the data points that I mentioned earlier were collected and reported, HMDA data would still be incomplete. That's because some of credit and risk related factors that lenders rely upon are not captured electronically. For example, the data doesn't capture the borrower's payment history related to past rents and mortgages. It doesn't capture information related to the borrower's employment stability, such as whether or not the borrower has seasonal work or is an independent contractor. And it doesn't give an assessment of the surrounding neighborhood and the value of nearby homes.

In its analysis of the 2004 HMDA data, the Federal Reserve reported that the "risk-based" pricing now used by the mortgage lending industry is working effectively. It has expanded access to credit and significantly contributed to the highest levels of home ownership in history. A record of nearly 70 percent of Americans now own their homes. Consumers are benefiting tremendously because mortgage lending is far more competitive than ever before. Today's unprecedented competition between lenders is keeping prices low and allowing consumers to shop around for a better-priced loan.

Finally, there's one point I'd like to emphasize: pricing disparities between borrowers who have different racial or ethnic backgrounds but identical personal and property risk profiles are unacceptable. The mortgage lending industry is committed to non-discriminatory lending practices. We continue to work with others who share our commitment to affordable lending to determine why any disparities exist so we can take the necessary steps to eliminate them.

I appreciate the opportunity to be here today and would be happy to answer any question you may have.

Testimony of Keith Ernst
Senior Policy Counsel
Center for Responsible Lending

Presented to the Subcommittee on Financial Institutions and Consumer Credit
June 13, 2006

Thank you Chairman Bachus, Ranking Member Sanders, and Members of the Committee for the opportunity to testify today. I want to take this opportunity to thank you, Chairman Bachus, specifically for your thoughtful leadership and persistence in addressing predatory mortgage lending and other vital issues that affect homeowners today. You and other leaders on the Financial Services Committee play an important role in determining how much confidence Americans can have in receiving fair and responsible mortgages as they buy homes and tap into their home equity in the subprime mortgage market.

We also appreciate this opportunity to comment on ways to strengthen the Home Mortgage Disclosure Act. Data collected and publicly disclosed under HMDA has been central in ongoing efforts to ensure fair and constructive lending. We believe the information we provide today will underscore the significance of HMDA data and its importance in encouraging a market for subprime home loans that is competitive and fair.

For many years, there have been concerns about potentially unfair pricing in the mortgage market. In 2000, a joint report by the U.S. Department of Housing and Urban Development and the U.S. Department of the Treasury noted that "[i]n predominantly black neighborhoods, subprime lending accounted for 51 percent of refinance loans in 1998—compared with only 9 percent in predominantly white neighborhoods."[1] These differences were observed to persist even when adjustments were made to account for differences in homeowners' incomes. Though disconcerting, these observations were not

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[1] *Curbing Predatory Home Mortgage Lending,* U.S. Department of Housing and Urban Development and U.S. Department of the Treasury, p47 (June 2000), at http://www.huduser.org/publications/hsgfin/curbing.html.

based on a direct measurement of the cost of mortgages, nor did they account for a broader set of risk factors routinely used to determine loan prices.

The first limitation was addressed last year, when the 2004 HMDA reporting requirements directed lenders to identify higher-rate loans.[2] Last fall, staff to the Board of Governors of the Federal Reserve System analyzed the distribution of these higher-rate loans.[3] They report pricing disparities between different racial and ethnic groups even after controlling for a borrower's income, gender, property location, and the loan amount. For example, after accounting for these differences, African-Americans who took a loan to purchase a home were 3.1 times more likely than white non-Hispanic borrowers to receive a higher-rate home loan; for Latino borrowers, the same disparity stood at 1.9 times.[4]

While this Federal Reserve analysis confirmed that African-American and Latino borrowers were more likely to receive higher-rate loans than white borrowers, the researchers were unable to broadly explore how these disparities were affected by risk factors such as borrowers' credit score, down payment, or ability to document income. To help advance the debate, my organization, the Center for Responsible Lending, has produced the first full research report that addresses this limitation.[5]

Specifically, we developed a database of 177,000 subprime loans by matching loans in HMDA to a private database of subprime mortgages. This step enabled us to bring together detailed information on mortgage pricing, loan terms, and borrower risk

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[2] Specifically, in the case of first-lien home loans, lenders were required to identify loans that carried an annual percentage rate that exceeded by more than three percentage points the yield on U.S. Treasury securities of a comparable term. *See A Guide to HMDA Reporting: Getting it Right!*, Federal Financial Institutions Examination Council (December 2003).

[3] Robert B. Avery, Glenn B. Canner & Robert E. Cook, *New Information Reported Under HMDA and Its Implication in Fair Lending Enforcement, Federal Reserve Bulletin* (Summer 2005), at http://www.federalreserve.gov/pubs/bulletin/2005/3-05hmda.pdf.

[4] Calculations from Keith S. Ernst and Deborah N. Goldstein, *Comment on Federal Reserve Analysis of Home Mortgage Disclosure Act Data*, Center for Responsible Lending Comment No. 1 (September 14, 2005), at http://www.responsiblelending.org/pdfs/cb001-FRB-091505.pdf.

[5] Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending (May 31, 2006). The study can be accessed at http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf.

characteristics in a single dataset. As a result, our study was able to account for those factors and isolate the effects of race and ethnicity in influencing whether a borrower receives a higher-rate loan in the subprime market.

Our findings were striking. We found that race and ethnicity—two factors that should play no role in pricing—are significant predictors of whether a subprime loan falls into the higher-rate portion of the market. Race and ethnicity remained significant predictors even after we accounted for the major factors that lenders list on rate sheets to determine loan pricing.

In other words, even after controlling for legitimate loan risk factors, including borrowers' credit score, loan-to-value ratio, and ability to document income, race and ethnicity matter. African American and Latino borrowers continue to face a much greater likelihood of receiving the most expensive subprime loans—even with the same loan type and the same qualifications as their white counterparts. Across a variety of different loan types, African American and Latino borrowers were commonly 30% more likely to receive a higher-rate loan than white borrowers.

In considering our study, it is important to understand that our analysis focused exclusively on subprime mortgages—those intended for borrowers with credit blemishes or other indications of higher-risk. Although it would be interesting to conduct a similar analysis across the entire mortgage market, data restrictions confined our focus to the subprime market.

Another key point about our study is that it did not involve approvals or denials of loans, but rather a study of the likelihood of getting the most expensive subprime loans. More specifically, for similarly-situated borrowers, we looked at the relative likelihood of getting a loan that crossed the line into the "higher-rate" pool of subprime mortgages.

The disparities we identified are troubling. For millions of families, owning a home ultimately makes the difference between merely surviving between paychecks or building savings for a better future. Unfortunately, race and ethnicity continue to be strongly correlated with wealth. In 2004, white non-Hispanic families had a median net worth of $140,700 while non-white or Hispanic families had a median net worth of $24,800.[6] Similarly, in 2004, 74 percent of white non-Hispanic families reported owning their primary residence versus just 47 percent of non-white or Hispanic families.[7] As a result, making mortgage credit arbitrarily more costly for African-American and Latino borrowers has significant implications, especially since ownership is also associated with higher attainments in education, better physical health and safer neighborhoods.

Even as we note the importance of these findings to African-American and Latino communities, it is important to understand that the pricing disparities identified in our research have implications for all families who receive subprime mortgages. Efficient financial markets should provide similarly-situated borrowers with equally competitive prices on subprime home loans. Yet, our results show this is not occurring.

Our methodology is not designed to pinpoint the underlying causes of pricing disparities; we can only verify that the disparities exist and that they are significant. However, in the report, we discuss a number of factors that likely contribute to the differences we found.

One reason relates to how lenders set prices on subprime loans. In the subprime market, substantial leeway exists for prices to be altered without regard to any credit-related criteria. The most obvious example is found in the context of "yield-spread premiums." Basically, yield-spread premiums are a bonus paid to brokers for placing borrowers in a loan with a higher interest rate. This presents a "reverse competition" problem, since it provides an incentive for brokers to deliver loans with higher rates to borrowers. In many

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[6] Brian K. Bucks, Arthur B. Kinnickell & Kevin B. Moore, *Recent Changes in U.S. Families Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances,* Vol. 92 Federal Reserve Bulletin pA4 (February 2006).
[7] Id at A20.

states, this incentive is not countered by a legal obligation on brokers to find a good deal for their customers or even to recommend a suitable loan.

Yield-spread premiums are often portrayed purely as a tool that allows borrowers an alternative method of paying broker charges that would otherwise have to be paid directly. However, recent research shows that borrowers pay the most when some of their brokers' compensation came from both yield-spread premiums and other up-front charges.[8] This evidence is consistent with brokers charging yield-spread premiums on top of, rather than in place of, other discretionary up-front fees.

Another possible explanation for pricing disparities relates to whether African-American and Latino borrowers disproportionately receive their loans from higher-rate lenders. For example, civil rights groups have pointed out that Latino communities are frequently targeted by higher-rate lenders who take advantage of borrowers who feel that they have fewer options.

In any case, the 2004 HMDA information shows that African-American and Latino families in the subprime market are more likely to receive higher-rate home loans, and even accounting for major determinants of loan prices fails to explain the disparity. Given this situation and the likely causes, there are several specific actions we recommend to encourage fair, risk-based pricing of home loans:

Our first recommendation is to address industry practices that encourage inflated charges on subprime home loans.

Pricing in the subprime mortgage market today is not always based on rational factors. It is clear that yield-spread premiums allow leeway to divert from risk-based pricing, with great potential to add unnecessary costs to homeowners. We believe there are several ways to achieve more rational pricing based on objective factors while still permitting

[8] Marsha J. Courchane, Douglas McManus & Peter M. Zorn, An Analysis of Mortgage Closing Costs (August 2004) (unpublished manuscript, on file).

broker compensation through yield-spread premiums when appropriate. For example, we strongly recommend that yield-spread premiums be counted when considering whether the cost of a subprime loan is high enough to warrant additional protections. Today the Home Ownership and Equity Protection Act specifically excludes yield-spread premiums in its calculation of points and fees. This is a loophole that affects subprime loans originated by mortgage brokers, which is well over half the market.

Our second major recommendation is to hold lenders and brokers responsible for providing loans that are suitable for a given borrower.

Financial professionals who sell stocks and other investments have long had an affirmative duty to ensure that the products they recommend are suitable for their customers. Although buying a home is the biggest investment most families ever make, lenders and brokers frequently have no such obligation. Lenders and brokers should be required to recommend loans that are suitable and reasonably advantageous to borrowers.

Third, and very importantly, we believe lenders should be required to disclose more detailed pricing and underwriting information in their HMDA data.

The new information in HMDA collected on the annual percentage rate on some loans is a valuable first step, but more can be done. To provide the most accurate picture of loan pricing possible, all of the costs associated with a home loan should be reported in HMDA, including points and fees, yield-spread premiums, and prepayment penalties. In addition, HMDA should include an indication of whether the loan was originated through a mortgage broker. Finally, HMDA data should include other information that would allow more insight into how loans are priced, such as loan-to-value ratios and credit scores. This information is fundamental to mortgage lending today, and would be a valuable tool in achieving greater fairness in subprime pricing. We believe that, working in good faith, interested parties can develop a workable mechanism for providing such information without unduly compromising privacy.

Fourth, we need more focused and transparent enforcement of fair lending laws.

One of the main goals of HMDA is to help identify potential discriminatory lending patterns and to enforce anti-discrimination laws. Last year, based on the raw disparities evident in the 2004 HMDA data, the Federal Reserve referred some 200 lenders to regulators for further investigation. To date, no information about the outcome of those referrals has been made public.

It is important for the public to know that regulators review and act on the information available to them in a timely and transparent fashion. We recommend that each regulator report annually on the number of fair lending examinations performed, and for each examination provide publicly-available information, including: (1) the indicators of potential discriminatory activity identified (if any); (2) the protected class or classes (e.g., gender, race) believed to be potentially disadvantaged by such activity; and (3) the outcome of each review (i.e., any actions taken). In the context of these examinations, we specifically urge the regulators to focus on the impact of discretionary pricing.

In addition, turf battles should not impede efforts to protect consumers. In the wake of the release of the 2004 HMDA data, the Office of the Comptroller of the Currency has put significant energy into a court action to prevent a state attorney general from having access to information necessary to evaluate potentially discriminatory practices by lending institutions.[9] It is not clear whether the same energy has been put into getting to the root of racial and ethnic disparities in home lending. It will take concerted efforts from all interested parties to ensure that similarly-situated families receive fairly-priced loans.

[9] *See* Office of the Comptroller of the Currency v. Spitzer, 396 F.Supp. 2d 383 (S.D.N.Y. 2005).

Finally, we urge Congress to review incentives and support a policy framework that leads the market to better serve all communities.

Some of the key goals of HMDA include determining whether financial institutions are serving the housing needs of their communities and helping public officials to make public investments in a way that attracts private investment in areas that need it. As discussed above, one reason African-American and Hispanic families are more likely to receive higher-rate loans may be that they tend to receive loans from lenders that generally charge more. Policymakers should review whether lower-cost lenders need additional incentives to help meet the credit needs of such communities. Conversely, regulatory enforcers of fair lending laws should actively evaluate whether the higher-cost lenders "reverse red-line" by targeting African-American and Latino communities for higher-priced products unrelated to individual borrower risk.

When unscrupulous lending practices go unchecked, borrowers are not the only ones who suffer harm; lower-cost lenders and honest brokers also are placed at a disadvantage. They cannot compete with lenders or brokers who make loans on unfair or deceptive terms or who push-market loans that are not in a borrower's best interest. In recent years, state laws and regulations that prohibit predatory, irresponsible subprime lending have proven effective in reducing the number of abusive loans while maintaining a vibrant market for subprime home loans.[10] Indeed, state predatory lending reforms offer important lessons for thinking about how to protect borrowers from abusive lending.

These are our major recommendations, which are presented in more detail in our full report.

As the Members of this Committee consider ways to strengthen HMDA data and prevent predatory lending, I know you all share the ultimate goal of ensuring that the subprime

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[10] Wei Li and Keith S. Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms*, Center for Responsible Lending research report (February 23, 2006) at http://www.responsiblelending.org/pdfs/rr010-State_Effects-0206.pdf.

market provides fairly-priced credit to all American families, offering them much-needed opportunities to build wealth. Yet, I would also note that the 2004 HMDA data shows that we still have substantial work ahead to realize this goal. As you reflect on how to accomplish this goal, I would respectfully urge you to recognize that some important solutions have already been proven effective in the states. Thank you once again for considering these recommendations and my testimony.

Written Testimony
of
Calvin Bradford, President
Calvin Bradford & Associates, Ltd.

on behalf of the National Fair Housing Alliance

Before the House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit

"Home Mortgage Disclosure Act: Newly Collected Data and What It Means"

June 13, 2006

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Before the House Financial Services Committee,
Subcommittee on Financial Institutions and Consumer Credit

"Home Mortgage Disclosure Act: Newly Collected Data and What It Means"

June 13, 2006

My name is Calvin Bradford. I am speaking here today on behalf of the National Fair Housing Alliance (NFHA). I want to thank the members of this Committee for inviting us to these important hearings. Professionally, I am President of Calvin Bradford & Associates, Ltd., a consulting firm that engages in research, policy evaluation, general consulting, and expert witness services in the fields of fair housing and community development. I am submitting this written statement to expand on and provide supporting details to my oral testimony.

Founded in 1988, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Headquartered in Washington, D.C., NFHA, through comprehensive education, advocacy and enforcement programs, provides equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

I have worked in the field of lending discrimination for thirty-five years. Since the National Fair Housing Alliance (NFHA) was founded, I have worked with the organization on many of its extensive educational, training, and enforcement programs in fair lending. I am also a member of the board of the National Training and Information Center (NTIC), which was founded in 1973 as a research and technical support provider to National People's Action and other community organizations that first initiated the movement against redlining and disinvestment. NTIC's newsletter, *Disclosure*, embodies both the initial organizing effort to seek lending disclosure and the fundamental democratic principle of ensuring that citizens have access to critical information about the forces that affect their lives and the vitality of their communities.

I am intimately familiar with the Home Mortgage Disclosure Act (HMDA). I worked with both the constituent organizations and the Congressional staff responsible for drafting the Home Mortgage Disclosure Act and the Community Reinvestment Act (CRA). I have produced two national studies of the uses of HMDA data for the U.S. Department of Housing and Urban Development (HUD) and made a survey of reinvestment programs linked to uses of HMDA for the Ford Foundation. Since they were first released, I have engaged in research and analysis using HMDA data. I have engaged in several studies of reinvestment lending programs that were developed from various forms of HMDA analyses. I have used HMDA data to develop the lending aspects of the HUD-mandated Analysis of Impediments to Fair Housing Choice for more than a dozen jurisdictions.

I have served as a consultant in fair lending enforcement on contracts with HUD and state and local enforcement agencies. I have served as an expert in at least fifty cases of lending discrimination and abusive lending practices. I am honored that I have been asked several times to come before Congressional committees holding oversight hearings on HMDA, CRA and fair lending enforcement.

Five Key Points

There are five key points that I want to make concerning HMDA and its role in fair lending enforcement.

I. Home Mortgage Disclosure Act Data Are Widely Used and Extremely Valuable In Fair Lending and Community Lending Activities.

HMDA has served extremely well the purposes for which it was intended. It has proven to be a dynamic law that has been expanded and improved to reflect the changes in the mortgage lending markets over time. However, it must be used properly in order to identify discrimination. In addition, we recommend additional steps to make the data more user-friendly, especially for the community-based organizations and others with limited resources.

II. Federal Fair Lending Enforcement Is Critical to Eliminate Housing Discrimination.

Even as a growing U.S. population becomes more diverse, our communities remain highly racially and ethnically segregated, and segregation continues to extract a high price in economic and societal terms. Segregation in our neighborhoods and communities weakens the overall infrastructure, results in a drain on the tax base and minimizes the capacity of local officials to provide essential services to their communities. The hazards of segregation illuminate the meaningful significance of ensuring equal treatment and promoting integrated neighborhoods.

III. Federal Regulatory Agencies Must Improve Their Fair Lending Oversight and Enforcement Activities.

The federal agencies that regulate insured depository institutions, particularly the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the Federal Reserve Board (Fed), have the authority to conduct an effective process for fair lending examinations. In the experience of many of us directly involved in training, education, and litigation, their record of enforcement falls short of the mark and has not been effective at eliminating discrimination from the mortgage market.

IV. HUD, Justice and the FTC Must Increase Their Fair Lending Enforcement Efforts.

The U.S. Department of Housing and Urban Development (HUD), as the lead enforcement agency under the Fair Housing Act and the administrator of the Federal Housing Administration, has a critical role to play in fair lending enforcement. However, it has undertaken very little fair lending enforcement activity. We are encouraged by the announcement last week of HUD's settlement of a lending discrimination case in Newport, Kentucky, on behalf of an African-

American complainant. At the U.S. Department of Justice (DOJ), which has brought several excellent and landmark fair lending cases in the past, fair lending enforcement activity since 2000 has not been as robust as that in the 1990s. The Federal Trade Commission has authority over non-regulated lenders under the Equal Credit Opportunity Act (ECOA), but it has pursued almost no lending discrimination cases.

V. No Agency Regulates Independent Mortgage Companies for Fair Lending Compliance.

Despite the utility of HMDA data for highlighting potential lending discrimination, analysis of the data has not led to effective enforcement of the fair lending laws for a growing segment of the mortgage lending industry, non-depository institutions. This is not a failure of the data, but a failure of the regulatory system. In our view, the Fed, which plays a lead role in this area, does not make effective use of its regulatory authority with respect to the non-depository institutions over which it has jurisdiction. These include some of the largest mortgage companies dealing in both prime and subprime lending. We believe that the Fed should take more aggressive action to ensure that these companies are in compliance with fair lending laws.

However, even if the Fed were to pursue aggressive supervision and enforcement with respect to bank holding company affiliates, that would still leave a significant segment of the market, namely unaffiliated non-depository institutions, without fair lending oversight. Although there are a few notable cases of state attorneys general who have used consumer protection statutes effectively to eliminate unfair and deceptive lending practices, on the whole, state regulation has not proven adequate to the task of fair lending enforcement. This is a gap that must be filled.

I. Home Mortgage Disclosure Act Data Are Widely Used and Extremely Valuable in Fair Lending and Community Lending Activities

HMDA generates one of the most commonly used government data sets, along with some routine economic indicators and Census data. HMDA data are used thousands of times each year by regulators, government agencies, lending institutions, community-based organizations, private fair housing and community development organizations, both independent and academic researchers, and parties engaged in fair lending education and enforcement.

A. HMDA Data Have Many Uses

HMDA was enacted to provide the public and public officials with data on mortgage lending patterns. These data were intended to: identify disparities in lending to focus attention on both individual lenders and neighborhoods with potential fair lending concerns; help regulatory agencies assess the performance of mortgage lenders; and help direct public sector investments in ways that would improve the environment for private investment. Since the first release of HMDA, community groups, civil rights organizations, and the media have used HMDA data to focus national attention on lending discrimination issues. HMDA has been a dynamic law with Congress responding to changing issues by making the original law permanent, expanding the range of lenders covered, and adding additional data to the disclosure requirements.

Over the past thirty years, HMDA has served society extraordinarily well. Its uses have undoubtedly exceeded the expectations of its authors. For example:

- HMDA has become the preeminent source of comprehensive data to track patterns and trends in the mortgage market. In recent years, academic researchers, government agencies, and scores of community groups have used HMDA data to document the emergence and dramatic expansion of the subprime mortgage market and its concentration in minority communities. I worked on one such study, "Risk or Race: Racial Disparities and the Subprime Refinance Market," published in 2002 by the Center for Community Change. That study analyzed subprime lending in every metropolitan area in the country and found considerable racial disparities in this segment of the mortgage market.

- The data are used to identify underserved markets and develop programs to address local needs in those markets. HMDA data have become an integral part of the Community Reinvestment Act (CRA) examinations conducted by the federal banking regulatory agencies. They are also widely used by community-based organizations to identify gaps in their local mortgage markets. Based on these analyses, local groups have built partnerships with lending institutions and local government agencies to develop and monitor reinvestment programs that have directed billions of dollars to underserved communities through targeted loan programs in both the primary and secondary markets.

- Individual lenders use HMDA data as part of their own analysis of their role in the larger markets and in assessing whether there are patterns in their lending that might be seen as possible indicators of discrimination. Thus, data have served to focus the industry on fair lending compliance more intensely than had been the case before the creation of the HMDA resource.

- HMDA data are also used extensively in fair lending enforcement to identify patterns that may indicate unfair lending practices. The data have been widely used for this purpose by a variety of government agencies, fair housing groups, and individuals, as described in more detail below.

The list of ways that HMDA data have been used is much longer, but these examples serve to underscore its utility.

We recommend that the Federal Reserve take two steps to enhance the public's ability to access and utilize HMDA data:

1. *Maintain a consistent record layout from year to year.* From time to time, the Federal Reserve switches the location of particular fields within the database, requiring users to retool the systems they have devised to analyze the data. This is a burden for individuals and organizations with limited resources and does not appear to serve a public purpose;

2. *After obtaining public input, provide the data in a format more readily compatible with current PC capabilities and widely-used software packages.* In an effort to assist community-based organizations and others with limited access to mainframe computers, the Federal Reserve developed a proprietary program for extracting subsets of HMDA data for more detailed analysis. While this may have been useful in the early 1990's, given today's technology, this program is a hindrance. There are several related issues whose resolution would make the data considerably more user-friendly. We urge you to encourage the Federal Reserve to reach out to the public to seek input on ways to accomplish this goal.

3. *Eliminate the mismatch between the resources and access to data that exists between government agencies and the public.* In a larger research sense, there is a lack of real openness which should characterize objective investigation of lending patterns. Present and past Federal Reserve economists (sometimes working with a small inner circle of other academics), as well as Fannie Mae and Freddie Mac, typically release studies based on HMDA data in conjunction with other data. This is the case with the Fed's use of the Georgetown Credit Research Center's data. We have what amounts to a private group controlling sets of unknown proprietary data that allegedly enhance the raw HMDA data. Organizations outside the private group are put in a compromised position. The members of the private group often criticize others using the HMDA data (or other occasional limited data sources) for not including the proprietary data sets that belong to this private group.

   These data sets, as well as regular samples of the loan data for Fannie Mae, Freddie Mac, the VA and FHA, should all be made public so that a wide range of researchers can work with common sets of data. Researchers commonly work with confidential data; there is no reason to believe that sharing the data with researchers subject to non-disclosure agreements would compromise either personal privacy protections or corporate proprietary rights. After other researchers have had ample time to work with these data sets themselves, there should be open forums in which different methods of analysis and differing results are presented and discussed.

B. HMDA Data Have Changed with the Market

Over the years, the mortgage market has changed dramatically. These changes are evident in the institutional structure of the mortgage lending industry; the role, size and structure of the secondary market; and the types of mortgage products available. One of the beauties of HMDA is that it has been adapted to reflect significant market changes, thus maintaining its utility as a tool for monitoring both market trends and individual lender performance, including fair lending compliance. Originally, HMDA required disclosure of loans made by depository institutions. Subsequently, its scope was expanded to require disclosure by non-depository institutions and to provide information on borrower characteristics and the disposition of individual loan applications. Most recently, the HMDA regulations were amended to provide information on loan pricing for "high cost" loans and to flag loans whose terms fall within the definition of the Home Ownership Equity Protection Act (HOEPA).

There are two additional changes that we believe would enhance the utility of the HMDA data. Both of these could be accomplished through regulatory action.

1. *Identify loans originated by brokers.* This is important because brokered loans now represent more than forty percent of mortgage originations, which is an enormous shift from just a few years ago. Further, many fair lending and consumer compliance concerns arise with respect to brokered loans, making it particularly useful to be able to identify these in the HMDA data.

2. *Modify triggers used for reporting loan pricing to reflect better the realities of the market.* Current regulations require lenders to report, for loans subject to Regulation Z (Truth in Lending Act), the difference between the annual percentage rate (APR) and the yield of Treasury securities with a comparable term when that spread is three points or more for first liens and five points or more for subordinate liens. This works fairly well for fixed-rate loans, which are typically tied to such long-term Treasury notes.

   However, for adjustable rate mortgages (ARMs), a shorter benchmark is typically used. The interest rate on ARMS is usually pegged either to a short-term "swap" rate or to the two-year LIBOR (London Inter-Bank Offering Rate). ARM rates are systematically lower than the interest on fixed rate loans. Thus, linking the rate spread trigger to the higher Treasury rate artificially suppresses the level of "high-cost" loans reported in the HMDA data. ARMs are one of the primary products in both the refinance and subprime markets, areas in which there are significant fair lending concerns. Therefore, we believe that it is important to establish a separate benchmark for reporting pricing data on these loans.

C. HMDA Data Are the Cornerstone of Fair Lending Enforcement

The data disclosed under HMDA have formed the cornerstone of both private and public fair lending enforcement efforts. Because of the private nature of the mortgage transaction, few borrowers have an opportunity to compare the terms and conditions of the mortgage they receive with those made available to similarly situated borrowers. Thus, it is very difficult, if not impossible, for individual borrowers to identify discrimination, even when they are its victims. Further, given the increasing complexity of mortgage instruments, the forms that lending discrimination may take are also increasingly complex. This makes data analysis a critical component of fair lending oversight and enforcement.

The data have been widely used by private individuals and organizations to further fair lending compliance.

- In the mid-1990s, for example, the National Fair Housing Alliance (NFHA) engaged in the first national lender testing project. NFHA analyzed HMDA data in eight metropolitan areas to determine the overall market patterns and identify lenders whose deviations from the market norms might indicate some form of racial discrimination. Using this analysis, NFHA tested selected lenders and found differential treatment in sixty-eight percent of the tests.

- This year, the Fair Housing Center of Greater Boston built on HMDA analyses to uncover differences in treatment for homebuyers of color in nine of twenty matched pair tests. At least seven of these tests showed differences clear enough to merit enforcement action.

- Analysis of subprime lending patterns has provided background information important in lawsuits brought by private attorneys that have set major legal precedents against the practice of reverse redlining and the targeting and exploitation of minority markets. These include the well-known cases of *Hargraves, et al. v. Capital City,* here in the District of Columbia, and the case of *Honorable, et al. v. Easy Life, et al.*, in Chicago.

HMDA data are also widely used by the various public agencies that have responsibility for fair lending oversight and enforcement.

- The federal banking regulatory agencies use HMDA data extensively in fair lending exams, as detailed in the FFIEC Fair Lending Examination Procedures manual. The Federal Reserve, FDIC, OCC and OTS also use the data in their CRA compliance.

- The Department of Justice (DOJ) has used HMDA data analysis in many of the fair lending cases it has brought. DOJ has used HMDA data to identify lending patterns and to map lending patterns geographically based on race. These cases were not "proven" with HMDA data, but they lent additional weight to evidence from other sources, including loan files. The maps show a compelling story for many lenders DOJ has sued as they show a paucity of branches and loans in minority neighborhoods.

- HMDA data are commonly used in the Analysis of Impediments to Fair Housing Choice, which HUD requires jurisdictions receiving Community Development Block Grant funds to conduct. Once lending barriers to fair housing are identified, jurisdictions are required to develop plans to overcome these barriers. HMDA data can not only be used to define the barriers, but they can be used by both the jurisdictions and the public to monitor progress toward the elimination of these barriers.

D. Important Issues of HMDA Data Analysis in Fair Lending Enforcement

There is considerable debate about the best techniques to use in HMDA data analysis. I would like to comment on a few of the issues that are most pertinent in the context of fair lending enforcement.

Too Much Emphasis Is Placed on Statistical Significance as a Benchmark for Measuring Discrimination

Although much of the academic research conducted with HMDA data strives to achieve high levels of statistical significance, this benchmark does not necessarily apply in the fair lending context. This would mean that, unless disparities along racial, ethnic, gender or similar lines were found at a statistically significant level, researchers would assert that discrimination is not a

factor in the marketplace. The problem with this approach is that statistical significance requires large numbers. Most lenders have a limited number of loans or applications in any given metropolitan area.

The use of statistical significance is likely one of the reasons the Fed's recent analysis of the 2004 data found so few disparities among "comparable" applicant types within specific loan products of individual lenders. A lender may engage in extremely discriminatory activity, but because of the relatively small number of records for analysis, this extreme activity might not produce "statistical significance" – especially at the required level for statistical significance used by the Fed in its analysis. Other types of measures and analysis need to be used if we are to use the HMDA data successfully to identify possible patterns of discrimination.

One approach to achieving statistical significance has been to combine different racial and ethnic groups into a single "minority" category. This may increase the number of "comparable" applicants or borrowers for statistical purposes, but it will mask differences between these racial and ethnic groups. For example, some Asian-American groups often have better access to mortgages than comparable white applicants in the same markets (though there are clearly regional and local markets where this is not the case). Hispanics tend to have lower levels of subprime or high cost loans than do African-Americans. Combining all of these groups into a single category tends to diminish the real disparities in the market.

Another approach has been to aggregate and analyze data for particular lenders at the national (rather than MSA) level. While this maximizes the number of applications and loans for analysis and may provide some useful profile data for that lender, it may also mask real differences in the lender's performance within particular MSAs. No lending study, including the analysis provided by the Fed each year, should focus exclusively on national patterns.

Rejection Rates as a Benchmark Do Not Necessarily Apply to Subprime Loans

In the prime mortgage market, much fair lending analysis has focused on rejection rates (along with other transactions where the loans were not completed, such as loans withdrawn, etc.). In the subprime market, however, where the question confronting a lender is less often whether or not to make a loan than how much to charge, the conclusions that one may draw from rejection rates are less clear.

On the other hand, to the extent that subprime lending plays a valuable role in access to credit, then rejection rates are just as important as they are in prime lending. The issue is to determine when denial is a good indicator of discrimination and when the infusion of subprime lending into minority markets is a good indicator of discrimination. In this complex situation, rejection rate analysis may have to be combined with particular patterns of market penetration and interest rate disparities or spreads.

Loans Originated by Brokers Make It Difficult to Measure Discrimination

With the growing dominance of the broker channel for delivering loans, rejection rates are even less helpful. This is because brokers tend to shop loans to several lenders. The lender that closes

the loan reports an origination, while any of the other lenders that approved the loan report a loan approved but not accepted. In other cases, a lender may provide a counter offer that may be as good or better than the loan that the broker decided to give the borrower. In such cases, the lender making the counter offer may have to report a rejection – which, in fact, represents a better deal that may not have been communicated to the borrower or that was received by the broker after another lender had made the deal. In these cases, the origination and rejection data are unclear and may even be misleading.

Analysis of Disparities by Gender Need More Attention

Historically, the analysis of differences by gender has been rare. With the growth of the subprime markets, however, there has been an increased focus the pattern of litigation on lending schemes that take advantage of women, either directly or as the result of targeting older homeowners who tend to be disproportionately female. Thus, more attention needs to be paid to examining differences in lending by gender.

II. Federal Fair Lending Enforcement Is Critical to Eliminate Housing Discrimination

Even as a growing U.S. population becomes more diverse, our communities remain highly racially and ethnically segregated, and segregation continues to extract a high price in economic and societal terms. Segregation in our neighborhoods and communities weakens the overall infrastructure, results in a drain on the tax base and minimizes the capacity of local officials to provide essential services to their community. The hazards of segregation illuminate the meaningful significance of ensuring equal treatment and promoting integrated neighborhoods. Not only do integrated neighborhoods create a more diverse community and reduce the concentration of poverty in a city, they also sustain better schools, more amenities, a healthier infrastructure, a stronger tax base and a broader mix of businesses. Fair lending is a key part of ensuring equal housing opportunity in our communities.

Private lawsuits have historically been important to the effort to eliminate lending discrimination. Currently, most fair lending cases are brought by private fair housing organizations and individual attorneys. While these private efforts are very important, the full engagement of the responsible federal government agencies is an essential and critical component of any serious effort to combat lending discrimination in all of its many, evolving forms.

Typically, in order to show that a member of a protected class was treated illegally in a mortgage transaction, one needs to know how other applicants where treated. This requires access to information that is not in the public domain. Most victims of lending discrimination are unlikely to know that they have been discriminated against. Indeed, where misleading, deceptive, or fraudulent practices are involved in the discrimination, the intent of the lending agents is to ensure that the person is not aware of these practices.

Private organizations do not have the resources needed to undertake investigation, analysis and litigation of fair lending violations on a routine basis. This requires review and analysis of a

wide range of documents related to marketing practices, underwriting and loan servicing policies, confidential personal data from actual loan files, and a variety of other information that lenders deem proprietary. For both policy and practical reasons, the federal government is best situated to undertake this effort.

If the government fails to pursue such cases or does not engage in a competent effort to uncover lending discrimination by the lenders under its authority, then most lending discrimination will go unchecked. Lack of forceful federal enforcement actually provides a form of safe harbor for those in the industry engaging in discriminatory practices.

III. Federal Regulatory Agencies Must Improve Their Fair Lending Oversight and Enforcement Activities

Disclosure is a valuable tool for the evaluation of lending pratices, but it cannot replace forceful and effective enforcement activities undertaken by federal agencies. Historically, public awareness of fair lending problems has been influenced by the actions of citizen organizations, private enforcement efforts, and the media. Many of these actions have been based upon HMDA data analysis, and these analyses have evolved as the mortgage market and the forms discrimination takes have evolved. If, however, we are to eliminate discrimination, the responsible federal government agencies must undertake aggressive, effective fair lending enforcement activities. Financial regulatory agencies have referred some lending discrimination cases to the Department of Justice for enforcement actions; however, they are few in number.

Fair lending examination reports are strictly confidential, so it is impossible for the public to review and evaluate them directly. However, the procedures used by examiners are public (see the FFIEC Interagency Examination Procedures), and these give us some sense of the agencies' approach. We can compare this to our own knowledge of the mortgage market and the points in the lending process that are susceptible to illegal discrimination.

A. Current Methods for Examining Prime and Subprime Affiliates Will Not Necessarily Identify Discrimination

One pivotal issue is the way the exam procedures handle the question of prime vs. subprime loans. From a fair lending perspective, when examining a lending institution that makes both prime and subprime loans, it is critical to review the institution's marketing and application procedures to ensure that all applicants have equal access to all reasonable products for which they qualify.

The examination procedures indicate that the "subsidiaries" of a lending institution should all be examined (page 3 of the FFIEC Interagency Examination Procedures) and that the examination should assess whether a lender with both prime and subprime affiliates has concentrated its subprime subsidiaries in minority neighborhoods and its prime subsidiaries in white neighborhoods (page 8). These are good procedures.

However, while the procedures consider racially segregated channels for different loan products as a potential indicator of differential treatment, they specifically state that affiliates (separate

companies within a holding company) should not be included in the examination and should not even be contacted (page 3). This allows institutions to use their corporate structure to evade fair lending review. It puts the onus on the Federal Reserve Board, as the umbrella regulator for bank holding companies, to make full use of its authority under the Bank Holding Company Act to ensure that no bank holding company affiliate is engaged in illegal discriminatory practices. It is not clear that the Fed is currently doing so.

There are a number of bank holding companies with prime and subprime affiliates. One such example is Citigroup, which has a prime lender (CitiMortgage) that operates both through retail offices and brokers, and a subprime affiliate (CitiFinancial) that operates through several thousand retail offices in local neighborhoods across the country. When Citigroup acquired The Associates, a major subprime lender, and merged it with CitiFinancial, many community groups raised concerns about how applicants that qualified for prime loans would have access to those loans if they entered through the subprime CitiFinancial channel.

One way that Citigroup could ensure that all applicants to any of its mortgage affiliates would have access to the full range of its mortgage loan products is for it to license its own CitiFinancial offices as brokers for CitiMortgage products. Certainly, Citigroup has more control over the quality and training of its own employees at the CitiFinancal offices than it has over independent brokers who are licensed to process CitiMortgage loans.

Based on the information on CitiFinancial's website, one might think this is what Citigroup has done. Indeed, under the link to "Products and Services" it states: "We have **a solution for every need and budget**". It adds, "**No matter What Your Situation, We Have a Solution!** At CitiFinancial, we don't just make you a loan – we become your partner in finding a solution."

However, this is not the case, as I determined last week by calling several CitiFinancial offices near where I live. When I asked if they could make me a loan from CitiMortgage, I was told, "no, if you want a loan from them, you have to go through their offices." I said, "So, you only make CitiFinancial loans and not CitiMortgage loans?" Staff in another office reported that, "even though we are all under the same umbrella, we have nothing to do with them (CitiMortgage)." I should note that there are no CitiMortgage offices in my area, making it difficult for potential applicants to gain access to prime mortgage products from Citigroup.

Thus, CitiGroup segregates its prime and subprime channels in a way that gives rise to fair lending concerns. It is not alone. Bank holding companies using this structure have an effective safe harbor under the agencies' fair lending examination procedures. In such a situation, it is critical for the Federal Reserve to conduct regular, comprehensive and aggressive fair lending compliance exams for non-depository bank holding company affiliates engaged in mortgage lending.

B. Current Methods of Examination Will Not Reveal Whether Everyone Is Receiving the Best Loan Product

For some time now, lenders have been grappling with how to set up an effective system to ensure that applicants get the best loan product for which they qualify, regardless of the channel (prime

or subprime) through which they enter the institution. Another concern for fair housing advocates is that all loan applicants have access to all of a lender's products through a single application process. The fair lending exam procedures list situations in which "a single loan processor could simultaneously attempt to qualify any applicant, whether to the bank or the mortgage company, under either the bank's prime criteria or the mortgage company's sub-prime criteria" as potential indications of steering (page 8).

Thus, for the regulatory agencies, the very structure that community lending advocates and fair housing organizations advocate to maximize fair lending sends up a red flag for potential discrimination. Of course, if the examination procedures are correct in flagging this structure as a possible sign of discrimination, then the entire wholesale market that operates through brokers that shop loans for the best deal should be held suspect simply by its very existence. In our view, brokers are a special case, because of the fact that their interest is not necessarily consistent with the best interest of their clients. To the extent that brokers provide borrowers with loans based on the compensation the broker receives, rather than the terms that best meet the borrowers' needs, the potential for abuse and illegal discrimination exists and may flourish. Currently, it is not possible for the public to identify which loans are originated through brokers. **We believe that the regulations should be revised to require lenders to identify loan applications originated by brokers.**

However extensive or comprehensive the examination procedures may appear to be, they may be suspended in cases where the supervisory agencies decide to use "regression analysis or other statistical methods of identifying potential discrimination with respect to one or more loan products" (page 1).

C. "Statistical Significance" Should Not Be the Prime Measure of Uncovering Discrimination

As described earlier, while statistical methods can be used in appropriate ways, they are not a wholesale substitute for other forms of analysis and, in fact, often serve to mask discrimination. Tests of statistical significance between groups are heavily dependent upon the number of cases (applicants or borrowers) in each group. The supervisory agencies use statistics to compare groups of applicants or borrowers who are "similarly situated" or "similarly qualified" except for race or some other protected class characteristic. In doing this, one needs to be careful that the definition of "similarly qualified" or "similarly situated" does not result in groups that are so small that even large differences in actual treatment or pricing do not meet the statistical tests of significance.

This is illustrated by a case I worked on in which we had access to detailed characteristics for over 16,000 loan applicants. Even with this pool, we were unable to identify borrowers who were precisely the same on all qualifying characteristics except for race. In this situation it was more reasonable to determine whether, for various minority applicants who had been rejected, white applicants who were clearly less qualified had been approved, especially with regard to the factors identified in the Adverse Action Notice as the basis for rejecting the minority applicants.

The need for alternative analytical approaches is critical. Each time an applicant from a protected class is denied a loan or offered one on terms and conditions inferior to those offered to an equally or less qualified control applicant, there is evidence of possible discrimination. This makes it critical for those charged with enforcing the fair lending laws to employ both statistical and non-statistical analysis in the oversight and enforcement process.

D. Even Overt Discrimination Sometimes Escapes Notice by Federal Regulators

Because there are no public documents about the results of fair lending exams, it is difficult to assess the quality of the fair lending examination process. Community Reinvestment Act (CRA) evaluations are supposed to contain comments on whether the regulator found any evidence of discriminatory lending practices. However, my litigation experience shows that the statements in these public disclosures do not always contain accurate information of the findings of the fair lending exams.

The recent case of Flagstar Bank, FSB, represents that rare exception where we actually have proof of fair lending violations that we can compare to the public comments of the institution's regulator and to the CRA ratings given to the bank before and after the violations occurred. This case illustrates the disconnect between some lending institution behavior and the fair lending examination process by the federal financial institution regulatory agencies.

- Between February of 1994 and November of 2005, during which time the OTS gave Flagstar Bank "Satisfactory" and "Outstanding" CRA ratings, this lender was sued numerous times in federal court for issues related to discrimination in lending. Most lending cases are either dismissed by the courts or settled. Flagstar, in contrast, was found liable for discrimination at trial or by the court in at least two of these cases.

- In 1999, a jury in Detroit found Flagstar liable for discrimination against minority borrowers, and plaintiffs were awarded damages. In 2003, in a national class action suit, a federal court in Indianapolis found a written pricing policy developed by Flagstar management in 2001 so overtly discriminatory that the court ruled against Flagstar on summary judgment. The policy explicitly stated that pricing would be different for minority and non-minority borrowers. It appears that the discriminatory pricing policy was developed and implemented by Flagstar *while* the OTS was conducting its consumer compliance examination.

- The OTS conducted five CRA examinations and never found Flagstar in violation of discrimination laws. During this time period, Flagstar was given a "Satisfactory" CRA rating four times and was elevated to an "Outstanding" rating after the summary judgment finding in 2003.

This took place despite the seemingly extensive fair lending examination procedures (see the Interagency Fair Lending Examination Procedures). These procedures call for the review of "lending policies, marketing plans, underwriting, appraisal and pricing guidelines" (page 6) and for the review of "complaints alleging discrimination in residential loan pricing" (page 8). The procedures call for the review of possible indicators of overt discrimination, "including explicit

prohibited basis identifiers in underwriting or pricing" (page 7). Clearly, these core examination factors were either ignored or the examiners for the OTS who were assigned to review one of the largest mortgage lenders in the nation did not understand the most basic tenants of fair lending.

Flagstar was one of the nation's twenty largest mortgage lenders during the period covered by this litigation. It sold loans to both Fannie Mae and Freddie Mac and was one of the largest underwriters of FHA loans through certification granted by HUD. After the judicial findings of lending discrimination, no sanctions were applied by the OTS, HUD, Fannie Mae, or Freddie Mac.

In fact, Flagstar was allowed to expand significantly during this time period by opening numerous branches, expanding into a new state, and expanding to additional metropolitan areas in these states. The approval of its applications to expand was based, in part, on its CRA ratings. As a result, during the period from 1994 through 2005, Flagstar grew from just over $500 million in assets to nearly $13 billion in assets.

The Flagstar case raises serious concerns about the adequacy and effectiveness of the regulatory agencies' fair lending enforcement efforts.

IV. HUD, Justice and the FTC Must Increase Their Fair Lending Enforcement Efforts

While the federal banking regulatory agencies have a key role to play in fair lending enforcement, other agencies also have important parts to play. As insured depository institutions lose market share to uninsured, largely unregulated mortgage lenders, the roles played by HUD, the Department of Justice (DOJ) and the Federal Trade Commission take on greater importance.

During the 1990s, the Department of Justice was a leader among government agencies in fair lending enforcement. Its activity was triggered by a Pulitzer Prize-winning series in the Atlanta Constitution-Journal, "The Color of Money," written by Bill Dedman. The series used HMDA data, along with additional data collected from thrifts by the Federal Home Loan Banks, and documented redlining and racial discrimination in Atlanta.

This series provided the Department of Justice with background for its first major investigation of lending discrimination in the case brought against Decatur Federal Savings & Loan. The attention given to these news stories also added impetus to legislation that eventually amended the HMDA and resulted in disclosure of data on borrower characteristics and the disposition of loan applications.

These DOJ investigations set in operation a process by which both HUD and the financial regulatory agencies could refer pattern and practice cases to DOJ for investigation and litigation. In many of the pattern and practice cases filed by DOJ, HMDA data are used to illustrate racial disparities consistent with the charges made in the cases. These cases have set out legal strategies and formats for investigation and litigation in a wide range of lending issues from redlining to retail and wholesale pricing.

Historically, the decade of the 1990s can be seen as the high point in federal enforcement efforts. As listed on its website, DOJ has filed twenty-three lending discrimination cases since the early 1990s, two of which are in the form of amicus briefs. Three of those cases allege discrimination in non-mortgage consumer credit transactions. Of the remaining eighteen cases, three have been filed since 2000. About half the DOJ cases have been referrals from OTS, OCC, or the Fed. DOJ cases filed since 2000 appear to be based on analysis of HMDA data from the late 1990s and early 2000s. We are not aware of what efforts or analysis DOJ may currently have in process. There may be a number of lending institutions currently under investigation. And, although

Aside from the recent settlement between HUD and Fifth Third Bank, the level of fair lending enforcement activity by the Department of Housing and Urban Development has been negligible. Assistant Secretary Kim Kendrick has made a commitment to improving enforcement efforts at HUD and to reinvigorating the Secretary-initiated complaint process. We look forward to working in partnership with the Assistant Secretary and her staff to achieve these goals and urge Congress to provide sufficient funding to HUD to allow it to enforce the many facets of the Fair Housing Act.

The Federal Trade Commission has authority over non-regulated lenders under the Equal Credit Opportunity Act (ECOA), but it has pursued almost no lending discrimination cases, although the FTC had an enforcement plan as far back as 1978 (See Discrimination in Real Estate Finance: The Role of the FTC Enforcement – A Report to the Federal Trade Commission, Pottinger and Company, 1978).

V. No Agency Regulates Independent Mortgage Companies for Fair Lending Compliance

The most glaring abyss in the federal enforcement effort, however, is in the large segment of the market outside of the normal regulatory environment. With the move in the mortgage market away from depository lenders and toward wholesale lending through brokers, the lack of enforcement activity in this area becomes a black hole within which many of the most abusive lending practices reside.

HUD has the authority as the lead agency in fair housing enforcement to initiate investigations and enforcement activities in this area, but, aside from some minimal cases of closing cost violations of RESPA, it has not brought any fair lending enforcement actions against independent mortgage companies.

The Fed has the authority to regulate the activities of bank holding company affiliates, which often account for the majority of the lending done by the holding company overall. However, to our knowledge, the Fed has never taken any fair lending enforcement action against any bank holding company mortgage affiliate, nor has it referred to the Department of Justice any cases involving these companies.

Conclusion and Final Recommendations

In summary, HMDA has been an invaluable tool used by community organizations, industry groups, and governmental agencies to educate the nation about lending practices and to identify potential signs of fair lending discrimination. That said, there are some changes that should be made to the HMDA data to make it a stronger tool. HMDA has been expanded and improved over the years to reflect changes in the marketplace; now is the time to make more of those changes to ensure public access to the data and to regulate non-depository institutions, a rapidly growing share of the marketplace. In addition, Congress, the Administration, and federal agencies must use their authority to undertake much stronger fair lending activities including investigations and enforcement.

The following are the recommendations we believe that Congress should oversee in response to the five key issues outlined at the beginning of this testimony:

- HMDA data should be more user-friendly, especially for community-based organizations and others with limited resources. The FFIEC needs to establish a funded advisory board, composed of a broad range of HMDA users and civil rights enforcement agencies and attorneys with successful experience in the lending enforcement area. Its role would be to provide assistance on how to make HMDA data more user-friendly and accessible and advice on how to restructure the federal examination and enforcement programs. This group could also serve to provide discussion and review of proposed changes to HMDA.

- Consideration should be given to enhancing HMDA disclosure data to include the identification of loans processed through mortgage brokers, as well as to defining separate high cost benchmarks for fixed rate and adjustable rate mortgages, and to recording the total fees as a separate item.

- Federal regulators and consumer organizations should work together to determine new HMDA data classifications that reflect the complexity of brokered loans. These loans often involve counter-offers which are technically a rejection but which may, in some cases represent a better product/terms for the consumer.

- Congress should allocate additional resources to HUD's Fair Housing Initiatives Program in order to facilitate increased education and enforcement efforts on the part of local fair housing organizations.

- Federal government agencies in general must undertake more aggressive, effective fair lending enforcement activities. These agencies should consult with experts in fair lending enforcement organizations so that the federal examination and enforcement programs reflect the best practices of the state of the art in investigation techniques and litigation strategies.

- Federal agencies that regulate insured depository institutions, particularly the OCC, the FDIC, the OTS, and the Fed, should use their authority to undertake stronger oversight and enforcement activities to eliminate discrimination from the mortgage market. They

should also re-examine their use of HMDA data to assure maximum coverage of potential fair lending violations. Any cases that regulators resolve with lenders on behalf of a few consumers should also be referred to DOJ for a pattern and practice investigation.

- The Fed announced publicly that it flagged 200 institutions for additional investigation because of their pricing data and other issues. This is a classic intersection between HMDA data and fair lending enforcement. Congress should ask the Fed for a status report on these investigations;

- The federal agencies tasked with enforcing the federal Fair Housing Act must expand their fair lending enforcement activities. These agencies need assistance from both Congress, in the form of appropriations to fund these initiatives, and from the Administration, in the form of political will. Congress should provide funding for a special mortgage lending unit at HUD, particularly in light of the predatory lending problems in the United States.

- The FTC must use its authority to undertake fair lending cases;

- All financial institutions active in lending must be regulated. To fill the vacuum of fair lending enforcement activity for non-depository institutions, the Fed should use its authority to ensure that these institutions are in compliance with the fair lending laws. If this authority is lacking, Congress should grant the needed authority.

Thank you once again for the opportunity to testify before this Committee. The National Fair Housing Alliance and I are available to answer any questions and assist in any way that we can to assure that this Committee, Congress, and the government as a whole fulfills its duty to enforce fair lending nationwide.

United States House of Representatives

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Hearing on
"Home Mortgage Disclosure Act:
Newly Collected Data and What It Means"

June 13, 2006

Testimony:

The New HMDA Pricing Data: What Can It Tell Us about Pricing Fairness?

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Testimony of Professor Michael E. Staten
United States House of Representatives
Committee on Financial Services
Hearing on "Home Mortgage Disclosure Act: Newly Collected Data and What It Means"
June 13, 2006

Good morning Mr. Chairman and members of the Committee. My name is Michael Staten. I am Professor of Management and Director of the Credit Research Center at the McDonough School of Business at Georgetown University. The Center is a non-partisan, academic research center devoted to studying the economics of consumer and mortgage credit markets. Over its 32-year history the Credit Research Center has generated over 100 research studies and papers, most of which examine the impact of public policy on retail credit markets. Throughout its history, the Center's research program has been supported by a mix of grants from the public sector (e.g., National Science Foundation, Federal Trade Commission) and unrestricted private sector grants from foundations and corporations made to its host University on behalf of the Center. I have served as the Center's director since 1990.

One of the government's tools for enforcing fair lending regulations for home mortgage loans was enhanced in 2005. Since 1989, regulations issued by the Federal Reserve Board (FRB) under the authority of the Home Mortgage Disclosure Act (HMDA) have required most financial institutions and companies that originate mortgage loans in the United States to report information on each mortgage loan application they received and processed during the previous year. In the past, the required information included the outcome of the application, location of the property securing the loan (at the census tract level for loans in urban and suburban areas), and the borrower's race and income. Beginning in 2005 (for loans originated in 2004), mortgage lenders were required to also report loan *pricing* information for the first time.

The new requirements to provide pricing data apply only to higher cost mortgage loans that comprise the large majority of the "subprime" mortgage market. The new HMDA database gives the FRB a more accurate tool for tracking subprime lending activity. It also allows the FRB to examine pricing patterns across institutions and neighborhoods according to borrowers' racial and ethnic groups. However, the HMDA data still do not contain information on many of the factors that determine the credit risk associated with the loan. As a result the new HMDA pricing data is not sufficient, by itself, to rationalize the price charged on loans, or to support conclusions about pricing fairness. The FRB has repeatedly noted that it intends to use the new pricing data *as a screening device to identify institutions or neighborhoods for closer scrutiny*.[1] It has

[1] Robert B. Avery, Glenn B. Canner, and Robert E. Cook, "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin*, Summer 2005, pp 389-392.

indicated that it will conduct such analysis for all institutions that report under HMDA, and will share the analysis with each federal agency responsible for regulating the reporting institution so that when pricing disparities are noted for a particular loan product originated by a particular institution, a closer look at loan files can be conducted through the agency's bank examination process.

Impetus for the New Reporting: Higher Priced (Subprime) Loans Have Expanded Mortgage Credit but Could Involve Excessive Pricing

The FRB's new reporting rules focus on the segment of the mortgage market that has provided one of the great success stories of consumer lending in the United States, at the same time generating increasing controversy. The subprime mortgage market has, without question, expanded home mortgage and home purchase opportunities to consumers with blemished or limited credit histories.[2] Prior to the early 1990s, the U.S. home mortgage market consisted of two distinct segments: 1) the conventional home mortgage market (i.e., "prime" mortgage) characterized by fairly rigid qualification standards, an accept/reject decision on applications, and a single price for accepted loans, and 2) the much smaller, government subsidized home loan market (i.e., FHA loans) that accommodated borrowers with lower downpayments and lower incomes. Consumers with poor credit histories and other weaknesses in their mortgage applications typically could not qualify for prime mortgage loans and often did not meet the eligibility criteria for FHA loans. These borrowers were effectively shut out of the home mortgage market and homeownership and associated wealth accumulation.

The adoption of risk-based pricing and flexible loan contracts by mortgage lenders during the 1990s triggered the phenomenal growth in what came to be known as subprime mortgage lending. Subprime mortgage borrowers are households who do not qualify for prime mortgage rates in the conventional mortgage market because of the higher risk they pose. A blemished credit history is one attribute that can prevent a borrower from obtaining a loan in the prime mortgage market. But other risk factors can push borrowers with good credit histories out of the prime mortgage market and into subprime loans. For example, borrowers with few assets available for a downpayment, unstable income or job history, or heavy current debt loads are unlikely to qualify for a prime mortgage loan because each of these factors raises the perceived risk of the loan. Subprime mortgage loans accommodate borrowers with a wide variety of individual circumstances that prevent them from obtaining prime loans at the lowest interest rates. Subprime mortgage loans are made at higher interest rates to compensate lenders for the additional risk.

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[2] Federal Reserve Board Governor Edward Gramlich remarked that "One of the key financial developments of the 1990s was the emergence and rapid growth of subprime mortgage lending. ...The increased availability of subprime mortgage credit has created new opportunities for homeownership and has allowed previously credit-constrained homeowners to borrower against the equity in their homes to meet a variety of needs." Remarks by Edward M. Gramlich at the Financial Services Roundtable Annual Housing Policy Meeting, Chicago, Illinois, "Subprime Mortgage Lending: Benefits, Costs, and Challenges," May 21, 2004.

Subprime lenders found plenty of demand for their product. Subprime loan originations increased at an average annual rate of 25 percent from 1994 to 2003, helping to propel homeownership rates in the United States from 64 percent to nearly 69 percent, an increase of over 9 million households. More than half of the gain is accounted for by minority households, for whom homeownership grew most rapidly. In 2004 subprime loan originations totaled $530 billion, accounting for 19 percent of all home mortgage loan originations in the United States.[3]

One notable characteristic of subprime loans is that they have a higher market share among low-to-moderate income households, as well as minority households, than is the case in the overall mortgage market.[4] The higher pricing of subprime loans and the high market share of subprime lenders in low-income and minority neighborhoods has elevated concerns by both regulators and consumer activist groups about the incidence of abusive lending tactics, including excessive pricing. Fueling these allegations have been studies that utilize the new HMDA pricing data and find a pattern in which some minority groups (not all) receive higher priced loans more often than non-Hispanic white borrowers. The FRB itself has noted relatively large differences in the "incidence" of higher priced loans for African-American and Hispanic borrowers, relative to non-Hispanic white borrowers. But, a significant difference in the raw frequencies does not necessarily raise fair lending issues. At the heart of the debate over the extent of discriminatory pricing in subprime mortgage lending is the question of whether similarly situated borrowers are treated the same by a given lender with respect to product choices and pricing, regardless of the borrowers' race or ethnic background. The new HMDA pricing data are helpful for beginning such analysis, but can not be used alone to draw any conclusions about the appropriateness of pricing.

The HMDA Pricing Data

Exactly what data have been collected? From 1989 through 2003, the Federal Reserve Board's Regulation C required covered institutions to collect and report information on applications for loans secured by a residential structure (including condominiums, cooperatives, and mobile or manufactured homes) if the loans were for a home purchase, refinance of an existing home loan, or a home improvement purpose (not open-end home equity lines of credit). The required information on each loan included (1) the date of the loan application, (2) the purpose of the loan, (3) the owner-occupied status of the property, (4) the amount applied for or the amount actually loaned if the loan was made, (5) whether the loan was approved or denied and the date of denial or closing, (6) location of the residential property by MSA, state, county, and census tract, (7) the race, ethnicity, and gender of the applicant, and (8) the gross annual income relied upon for the purposes of the application. Institutions did not report the interest rate (price) for

[3] *Inside B&C Lending*, Vol. 10, Issue 4, February 14, 2005, p 1.
[4] Glen B. Canner, Wayne Passmore, and Elizabeth Laderman, "The Role of Specialized Lenders in Extending Mortgages to Lower-Income and Minority Homebuyers," *Federal Reserve Bulletin*, pp 718-719 (November 1999). Randall M. Scheessele, *Black and White Disparities in Subprime Mortgage Refinance Lending*, Office of Policy Development and Research, Department of Housing and Urban Development, 2002.

the loan, nor any other characteristics of the borrower, the property securing the loan, or the loan contract.

New HMDA Data Fields Available for Loans Made in 2004

For loans originated on or after January 1, 2004, institutions covered by the HMDA reporting requirements must report the following data items, in addition to the fields previously reported:

- Loan price: Lenders must report loan pricing information for loans on which the Annual Percentage Rate (APR) exceeds the yield for Treasury securities of comparable maturity by 3 percentage points for first-lien loans and 5 percentage points for subordinate-lien loans (e.g., second mortgages). The information to be reported is the spread over the comparable Treasury security (i.e., APR – yield on the comparable Treasury), as opposed to the APR itself.

- HOEPA Classification: This is another price-related item. Lenders must indicate whether a loan is covered by the Home Ownership and Equity Protection Act (HOEPA). Mortgage loans fall under the scope of HOEPA regulations promulgated by the FRB if the loan APR exceeds certain pricing thresholds (currently 8 percentage points above comparable maturity Treasury securities for first mortgages and 10 percentage points above comparable maturity Treasury securities for subordinate-lien loans), or if the loan fees exceed a specified amount. HOEPA loans are considered "high-cost" loans and are therefore subject to a more stringent package of consumer-protection regulations.

- Lien status: Lenders must report the lien status (first-lien vs. subordinate-lien) for originated loans.

- Manufactured Housing loan: Lenders must report whether the loan is secured by a manufactured home.

What Can the New HMDA Data Tell Us About Pricing Fairness?

First and foremost, the HMDA loan data tell us where mortgage loans are made. The data are very good at their original purpose: indicating the geographic and racial/ethnic patterns of mortgage loan activity. The new pricing data for higher cost loans make a valuable contribution to the FRB's analysis of mortgage markets, but is also subject to some significant limitations. The HMDA data will more accurately identify subprime loans, as well as even higher cost loans subject to HOEPA coverage. Researchers inside and outside the regulatory agencies no longer have to rely on rough approximations for subprime activity. Although some subprime lending activity still falls outside the scope of HMDA coverage or below the pricing thresholds for reporting the APR spread, the pricing data reported from the broad range of covered institutions captures a large majority of the subprime market, allowing more accurate tracking of

subprime activity and growth. All of this substantially improves the FRB's ability to monitor the increasingly important subprime segment of the market.

But, the FRB recognizes that HMDA loan data is not sufficient, by itself, to rationalize the price charged on loans, or to support analysis of pricing fairness. Former Federal Reserve Board Chairman Alan Greenspan acknowledged that concerns about discriminatory pricing "suggested to us the need to revise our HMDA data collection in order to gather information on rates charged to aid us in seeing if, in fact, differences in rates are truly driven by differences in risks and costs and not tainted by discrimination. We recognized that such conclusions require far more detailed evaluations than is possible using HMDA information alone, with or without the additional data on rates. Nonetheless, the pricing data will assist us as a screening tool to facilitate self-monitoring and enforcement activities. If screening suggests that there might be a fairness issue, additional information will need to be collected from banks' loan files or other sources."[5]

The HMDA reporting process was not designed to mimic or replicate the data collection that mortgage lenders undertake during the application and underwriting process. Far more characteristics about the borrower, the property, and the loan itself are omitted from the HMDA reporting process than are included.

Consider the following characteristics of a loan that are *not* included in the HMDA data, but are well known to influence the risk associated with the loan and consequently the loan price: [6]

- Loan-to-Value ratio (LTV – indicating borrower equity and lender exposure to loss in foreclosure): Higher LTV loans carry more risk.
- Fixed rate vs. Adjustable rate vs. Hybrid Adjustable rate: Fixed-rate loans impose greater interest rate risk on the lender. If rates move higher, the lender is locked into a lower rate of return on outstanding fixed-rate mortgages. Lenders charge a premium for longer duration fixed-rate loans.
- Loan term: A quick scan of lender rate sheets reveals that 30-year fixed-rate loans carry higher interest rates than 15-year fixed-rate loans, because the former locks in the lender for a longer period.
- Assessment of property volatility and risk: An accurate estimate of the value of the collateral is a critical component to the lender's assessment of risk. Factors such as the value of the property relative to other homes in the neighborhood, the average time-to-sale for listed properties, the recent trends in appreciation or

[5] Remarks by Federal Reserve Board Chairman Alan Greenspan before the Independent Community Bankers of America National Convention, San Antonio, Texas, March 11, 2005.

[6] For good examples of studies that utilize these and a host of other factors, see Collins, Harvey, and Nigro, "The Influence of Bureau Scores, Customized Scores and Judgmental Review on the Bank Underwriting Decision-Making Process, *Journal of Real Estate Research*, Vol. 24, No. 2, 2002; Ambrose and Sanders, "High LTV Loans and Credit Risk," *Journal of Real Estate Finance and Economics*, forthcoming; Courchane, Nebhut, and Nickerson, "Lessons Learned: Statistical Techniques and Fair Lending," *Journal of Housing Research*, Vol. 11, Issue 2; Glennon and Stengel, "Evaluating Statistical Models of Mortgage Lending Discrimination: A Bank Specific Analysis," *Real Estate Economics*, Vol. 27, Issue 2, 1999.

depreciation, and the owner-occupancy rate of the neighborhood all affect the underwriting risk associated with a mortgage secured by the property.

Consider further the following characteristics of the *borrower* that are not included in the HMDA data, but are also well-known to influence the risk associated with the loan and the resulting loan price:

- Total debt: Knowing income from the HMDA data is not sufficient to judge the borrower's ability to repay a mortgage loan of given size. Lenders utilize payment-to-income ratios, which are driven by the magnitude of the borrower's outstanding debt, and its composition (e.g., installment vs. revolving). Required minimum monthly payments are critical to determining payment-to-income ratios.
- Assets: Mortgage lenders look for evidence of a cushion that the borrower has to fall back on in the event of unexpected expenses and income shocks. Fewer assets translate into higher risk.
- Credit score: Lenders utilize a variety of summary measures of a borrower's past payment history and current creditworthiness. Credit scores are purchased from commercial vendors such as Fair Isaac Corp., and the major credit bureaus (e.g., TransUnion, Equifax, and Experian), and are also developed internally through proprietary software by larger mortgage lenders.
- Specific delinquency history: Beyond the summary credit score, mortgage lenders are concerned with how borrowers have handled mortgage loans in the past and whether they have had incidents of serious delinquency (90 days or more) on other types of loans. Independent of the borrower's credit score, a higher incidence of delinquency, especially recent delinquency, signals significantly higher risk.

Clearly, a lender that knows only the mortgage applicant's income, race, and the location of the property would be in no position to make a responsible decision to accept or reject the application, or set a price on the loan. For the same reasons, no researcher (or regulator) can judge the appropriateness of the price actually charged based only on the lender's HMDA data. *This is why the FRB intends to use the new HMDA pricing data as a screening device to identify institutions or neighborhoods for closer scrutiny.* The FRB has indicated that it will conduct such analysis for all institutions that report under HMDA, and will share the analysis with the federal agency responsible for regulating the institution so that a closer look at loan files can be conducted through each agency's bank examination process.

Results from Analysis of the 2004 HMDA Data

The principal findings from analysis of the 2004 HMDA data are discussed thoroughly by Federal Reserve Board authors Robert Avery, Glenn Canner, and Robert Cook in their *Federal Reserve Bulletin* article.[7] Their analysis focused on differences

[7] Avery, Canner, and Cook, 2005.

across racial groups in 1) loan rejection rates, 2) incidence of higher priced (reportable) loans, and 3) the average price paid by those who receive higher priced (reportable) loans.

The raw data (unadjusted for borrower or loan characteristics) for 2004 show that African-American and Hispanic borrowers have a higher incidence of higher priced loans relative to non-Hispanic whites (and Asians). For example, in the category of first-lien loans used to purchase a home ("purchase money firsts"), 32.5 percent of African-American borrowers received higher priced loans, compared to 20.3 percent of Hispanic borrowers, and 8.7 percent of non-Hispanic white borrowers. Recognizing that the raw incidence percentages provide an incomplete and misleading picture of pricing fairness across racial/ethnic groups because they don't account for differences in the risk of either borrowers or loans, the authors describe analytical adjustments that control for those factors that are known to affect the loan underwriting decision (and assessment of loan risk) and are also contained in the HMDA data. While the HMDA data are limited, they do contain information on borrower income, geographic location of the property, property type (e.g., single family home, condo, etc.) and the identity of the lender. After adjusting for those factors that are contained in the HMDA reports filed by lenders, the percentages of first lien home purchase loans made as "higher priced" fall to 15.7 percent for African-American borrowers and 11.5 percent for Hispanic borrowers, as compared to 8.7 percent for non-Hispanic white borrowers.

Of the remaining differential, the authors state that "We emphasize that the Federal Reserve's statistical analysis system is only a screening tool. The HMDA data alone, no matter how much they are manipulated, cannot be used to conclude whether a particular applicant was treated adversely on the basis of a prohibited factor regarding either the disposition of the application or the pricing of the loan. The data reveal little about an individual's financial circumstances [e.g., borrower risk score, total debt, loan-to-value ratio, documentation and stability of income] and nothing about the condition or value of the property offered as collateral."[8]

To further investigate how the inclusion of additional borrower and loan information can affect fair lending analyses, the FRB asked the Credit Research Center (CRC) (for which I serve as director) at Georgetown University to collaborate on a study using one of the Center's databases. This database contains over 5 million loans made over the past nine years by eight lenders that specialize in subprime lending. The FRB estimated that loans from these eight lenders accounted for about 22% of the higher priced conventional home purchase and refinance loans in the HMDA database for 2004. Because the CRC database contained information on loan and borrower characteristics in addition to what were reported under HMDA, analysis of racial differences in pricing could be expanded to accommodate a broader array of factors that affect loan underwriting and pricing. The analysis revealed that, compared to the raw (unadjusted) incidence rates of higher priced loans, the differences between African-American borrowers and non-Hispanic white borrowers narrowed when HMDA-reported factors were included, consistent with the FRB's own analysis of its 2004 HMDA database.

[8] Id., p 389-390.

Moreover, the differential declined further when the additional loan-level attributes (not reported under HMDA) were included. Those additional attributes included borrower FICO score, loan-to-value ratio for first-lien loans, the appraised value of the property, type of interest rate (fixed, variable), low documentation of income, whether the loan carried a prepayment penalty, and whether the loan was originated through a broker.

But, even this expanded list of attributes doesn't capture all of the factors that are important to the underwriting process. Our database contains only what these lenders had stored electronically in their operating systems. Individual loan files contain even more information, along with original documents, credit reports, and other related items. Such information is also important in determining loan pricing. For example, I have seen lender rate sheets that indicate add-ons to a base interest rate related to FICO score and the number and recency of mortgage delinquencies, or even serious delinquencies on non-mortgage accounts. Our database contains the FICO score, but no information about prior delinquencies. We cannot replicate the pricing process with our data because we know we are missing some relevant data.

The message here is that analysis of pricing fairness is greatly affected by the amount of available information regarding both the borrower and the loan risk characteristics. When the available data are known to be incomplete, analysis is preliminary and conclusions are necessarily premature.

The FRB has been saying this repeatedly for more than a year. Nevertheless, the fact seems to be lost on some activist groups who persist in claiming to have found evidence of discriminatory pricing in the HMDA data and chastise federal regulators for failing to investigate.[9] The fact is that no study based on HMDA data alone can generate a conclusion that any lending institution has violated fair lending laws, nor can studies like our own that utilize an expanded but still incomplete set of loan-level characteristics. Good intentions notwithstanding, this sort of statistical effort is destined to fail, although it can apparently attract a lot of media attention along the way.

I am convinced that the only reliable way to reach defensible conclusions about fair lending practices is through a combination of statistical analysis and loan file review through the examination process, the approach that is apparently used by the Federal Reserve. I refer interested parties to two papers by economists with regulatory agency experience that present results from actual fair lending examinations. Both papers demonstrate rather convincingly how inspection of loan files can significantly alter conclusions reached through portfolio-wide statistical analysis alone.[10]

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[9] Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li, "Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages," Center for Responsible Lending, May 31, 2006; National Community Reinvestment Coalition, "Homeownership and Wealth Building Impeded: Continuing Lending Disparities for Minorities and Emerging Obstacles for Middle-Income and Female Borrowers of All Races," April 2006.

[10] Paul S. Calem and Stanley D. Longhofer, "Anatomy of a Fair-Lending Exam: The Uses and Limitations of Statistics," FEDS Working Paper No. 2000-15, March 2000; Jason Dietrich, "Under-specified Models and Detection of Discrimination: A Case Study of Mortgage Lending," *Journal of Real Estate Finance and Economics*, Vol. 31, No. 1, 2005.

Why Not Require More Data to be Reported?

If more information would be helpful, wouldn't it be a good idea to require even more detail as part of the new reporting requirements? The answer to this question is greatly affected by the extent to which reported items would be publicly disclosed.

Suppose lenders were required to provide more detailed loan-level risk factors to the FRB, but for its internal use only. A requirement to report additional loan-level details imposes a greater regulatory compliance burden. If the data were to be restricted to the FRB's internal use only, the requirement to expand reporting is redundant to some degree as the five regulatory agencies that comprise the Federal Financial Institutions Examination Council (FFIEC, which includes the Federal Reserve, the OCC, FDIC, OTS, and NCUA regulatory agencies) already have the power through the regulatory bank examination process to audit individual loan files. Details from selected loan files could be gathered when statistical screening revealed a potential problem, without forcing lenders to do so for every loan originated during a year. More fundamentally, the determination of what should be reported by lenders is problematic. Assuming that nobody is seriously contemplating having lenders report all of the information in a loan file, which items would be sufficiently important to require reporting? This is not as straightforward as it sounds. Credit score comes to mind as a likely candidate, but lenders utilize many different scores. Should the FRB endorse one above all others (e.g., the FICO score developed by Fair Isaac Corp.), when all scores relied upon by lenders have been proven to be effective (by law)? Moreover, certain lenders place different emphasis on some risk factors relative to others, depending upon their appetite for risk and proprietary skills at utilizing data to estimate that risk. Requiring the reporting of a standardized but necessarily limited set of "potential" underwriting factors runs the risk of effectively stifling innovative developments in underwriting processes or missing key variables that some lenders already use.

Now, suppose that an expanded reporting requirement would also include public disclosure of the data elements, just as current HMDA elements are annually disclosed. Such a process would quickly compromise the privacy of borrowers. Both FRB staff and academic researchers have demonstrated that it is *already* quite possible to match publicly available HMDA loan-level data with publicly available information on property transfers to identify the race and income of owners with a high degree of accuracy. "More than 90 percent of the loan records in a given year's HMDA data are unique—that is, an individual lender reported only one loan in a given census tract for a specific loan amount. These unique loan records can be matched with other publicly available information, such as property deed records, to determine the identities of individual borrowers. With such a match, any data item in the HMDA database, such as loan pricing, becomes publicly known."[11] Given the ability to match HMDA data to public records of property transfers, an expanded collection and public release of data on credit scores and other borrower attributes would severely compromise personal privacy. Regardless of how useful selected items might be to researchers outside the regulatory agencies (remember, the agencies themselves already have the ability to obtain more

[11] Avery, Canner, and Cook, 2005, p 367.

detail when they need it), the infringement on personal privacy is virtually unthinkable given today's regulatory commitment to privacy protections.

Conclusions

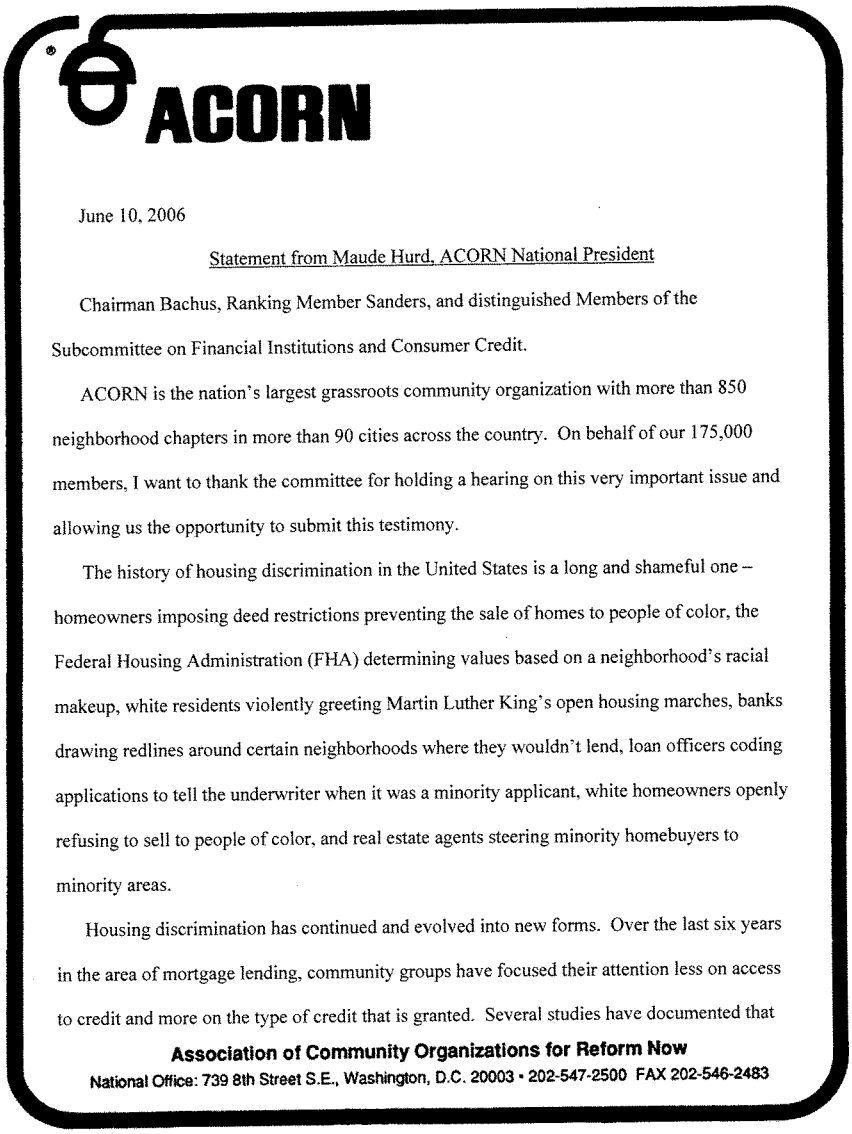
HMDA was designed to provide information about the extent to which mortgage loans are available to borrowers across geographical neighborhoods and borrower income and racial/ethnic groups. With the addition of pricing data for some loans, the HMDA database now provide more accurate information on subprime lending as distinct from prime lending. The database is a gold mine for researchers, but also for marketers seeking to identify underserved neighborhoods that may be ripe for competitors to woo borrowers with more favorable rates. However, HMDA was not designed to provide information on the range of characteristics of the borrower, the property, or the loan itself that determine the loan price. Consequently, the HMDA data alone can not be used to identify discriminatory pricing.

I will close with a final thought regarding the misuse of the HMDA pricing data. Attempts to infer excessive or discriminatory pricing using HMDA data alone may make good copy for the popular press, but they are unfair to targeted institutions, run the risk of doing serious reputational damage when none is warranted, and could prompt lenders to pull back from making "reportable" loans. This outcome would hurt the very borrowers that fair-lending statutes were intended to help. Presumably this is why the Federal Reserve Board launched a public-education campaign in March 2005 to delineate the strengths and limitations of the new HMDA data. A speech by Federal Reserve Board Governor Susan Schmidt Bies highlights the risks of improper use:

> "If the HMDA data set's inherent limitations are not acknowledged and understood, conclusions purportedly drawn from these data alone run a risk of being unsound. Unsound conclusions, in turn, may reduce the data set's effectiveness in promoting HMDA's objectives of improving market efficiency and legal compliance. For example, the unwarranted tarnishing of a lender's reputation could reduce the willingness of that lender or another to remain in, or enter, certain higher-priced segments of the market. That discouragement, in turn, could potentially reduce competition in those segments and curtail the availability of credit to higher-risk borrowers."[12]

Mr. Chairman, I thank you for the opportunity to share these thought today and would be happy to answer any questions.

[12] Remarks by Federal Reserve Board Governor Susan Schmidt Bies at the Financial Services Roundtable Annual Meeting, March 31, 2005.



ACORN

June 10, 2006

Statement from Maude Hurd, ACORN National President

Chairman Bachus, Ranking Member Sanders, and distinguished Members of the Subcommittee on Financial Institutions and Consumer Credit.

ACORN is the nation's largest grassroots community organization with more than 850 neighborhood chapters in more than 90 cities across the country. On behalf of our 175,000 members, I want to thank the committee for holding a hearing on this very important issue and allowing us the opportunity to submit this testimony.

The history of housing discrimination in the United States is a long and shameful one – homeowners imposing deed restrictions preventing the sale of homes to people of color, the Federal Housing Administration (FHA) determining values based on a neighborhood's racial makeup, white residents violently greeting Martin Luther King's open housing marches, banks drawing redlines around certain neighborhoods where they wouldn't lend, loan officers coding applications to tell the underwriter when it was a minority applicant, white homeowners openly refusing to sell to people of color, and real estate agents steering minority homebuyers to minority areas.

Housing discrimination has continued and evolved into new forms. Over the last six years in the area of mortgage lending, community groups have focused their attention less on access to credit and more on the type of credit that is granted. Several studies have documented that

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when buying or refinancing a home, borrowers of color, and African-Americans in particular, receive mortgages with much less favorable terms than whites receive. African-Americans have been segregated into the subprime market where they receive loans with higher interest rates, larger fees, and onerous features such as prepayment penalties.

The Federal Reserve's revised Home Mortgage Disclosure Act (HMDA) guidelines were an important step in addressing these racial disparities and made HMDA data much more relevant.

The origination of subprime loans to prime borrowers is one of the most egregious predatory lending practices, especially when it is conducted on a large scale and is perpetrated against specific communities. Given the explosion of subprime loans, the quantity of loans originated has become much less significant on its own, and instead must be viewed in conjunction with the quality of the loans.

This new data has allowed community groups to more fully understand a lender's mortgage business. For instance, one of the country's largest lenders, Wells Fargo, has for years boasted that it is the largest lender to African-Americans. However, when ACORN reviewed the combined totals of Wells Fargo's lending operations, we found that one out of every four mortgages made to African-Americans was a high rate loan (24.71%) compared to just one out of every thirteen loans to whites (7.44%).

Many in the lending industry argue that the disproportionate concentration of subprime loans among minority borrowers is only a reflection of the greater risk that these borrowers represent based on their lower credit ratings. However, Fannie Mae has stated that the racial disparities in subprime lending cannot be justified by credit quality alone and has estimated

that as many as half of the borrowers in subprime loans could have instead qualified for a lower cost mortgage.

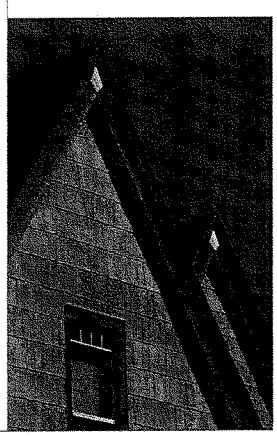
The industry has responded to the findings from the new data the same way they responded to the findings from the old data. Lenders argue that the HMDA data only tells part of the story since it does not include other information about a borrower such as credit, loan to value, and debt to income ratios. However, it is these same lender representatives who oppose the collection and reporting of this additional loan data. We strongly believe that credit, loan to value, and debt to income ratios should be included in HMDA data.

There is additional information that we recommend including in HMDA data in order to fully capture whether there are racial disparities in loan terms, such as prepayment penalties, which are not reflected in the APR.

Another area is in the difference in cost between fixed and adjustable rate mortgages. Although technically correct, the APRs on subprime LIBOR-based ARMs originated in 2003 and 2004 failed to reflect the huge increases in costs that borrowers who received these loans would experience.

For example, a borrower who received an ARM in March 2004 that had an initial interest rate of 6.2% and a margin of 5 basis points had the same APR as a mortgage with a 6.2% fixed rate. However, just two years later, while the fixed rate interest rate remained at 6.2%, the adjustable rate would now have a fully indexed interest rate of 10.3%.

Thank you.



Unfair Lending:

The Effect of Race and Ethnicity on the Price of Subprime Mortgages

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May 31, 2006

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Brief Synopsis

This study extends previous analyses of home loan pricing disparities by supplementing HMDA data with additional loan-level information from a large, proprietary subprime database. By merging the datasets, we were able to evaluate whether race and ethnicity affect subprime loan pricing after controlling for key risk factors, including credit scores and loan-to-value ratios. The results show that African-American and Latino borrowers are more likely to receive higher-rate subprime home loans than white borrowers, even when we control for legitimate risk factors.

Acknowledgements

The authors would like to thank David Rodda of Abt Associates, Eric Belsky and William Apgar of Harvard's Joint Center on Housing Studies, Raphael Bostic of the University of Southern California, and members of the Center for Responsible Lending's Research Advisory Council for their thoughtful insights and suggestions. In addition, we appreciate the support of all of our colleagues at CRL, especially the tireless research support provided by Peter Smith, the excellent policy insights of Jamie Goodson and Kathleen Keest, and the superb editing of Mary Moore.

I. EXECUTIVE SUMMARY

Last year, for the first time, lenders were required to report details on the costs of subprime home loans—mortgages intended to serve borrowers with blemished credit or other high-risk characteristics. Lenders disclosed pricing information related to the most expensive subprime loans (referred to here as "higher-rate" loans), while lower-rate loans in the subprime market and virtually all prime loans were exempt from this reporting requirement. Several analyses of this information, collected under the Home Mortgage Disclosure Act (HMDA), have shown that African-American and Latino borrowers received a disproportionate share of higher-rate home loans, even when controlling for factors such as borrower income and property location.

A number of concerned groups have pointed to these disparities as evidence of discrimination that slows economic progress among groups who already lag far behind in homeownership and wealth. Others contend, however, that the pricing disparities are not meaningful, since they do not fully account for legitimate differences in credit risks. In this report, we attempt to move the debate forward by providing a more detailed examination of pricing patterns in the subprime home loan market. Our study analyzed subprime home loan prices charged to different racial and ethnic groups while controlling for the effects of credit scores, loan-to-value ratios, and other underwriting factors. To our knowledge, this is the first full research report that examines 2004 HMDA data to assess the effects of race and ethnicity on pricing in the subprime market while controlling for the major risk factors used to determine loan prices.

Our findings show that, for most types of subprime home loans, African-American and Latino borrowers are at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors. The disparities we find are large and statistically significant: For many types of loans, borrowers of color in our database were more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in risk.

This analysis was possible because we supplemented the 2004 HMDA data with information from a large, proprietary subprime loan dataset. Individually, both databases lack certain pieces of data that would be helpful for an in-depth comparison of subprime loan pricing. By combining loan information from both sources, however, we obtain more complete information on a large set of loans. Using a combined dataset of over 177,000 subprime loans, we analyzed whether borrowers of color are at greater risk of receiving higher-rate subprime loans than similarly-situated white borrowers.

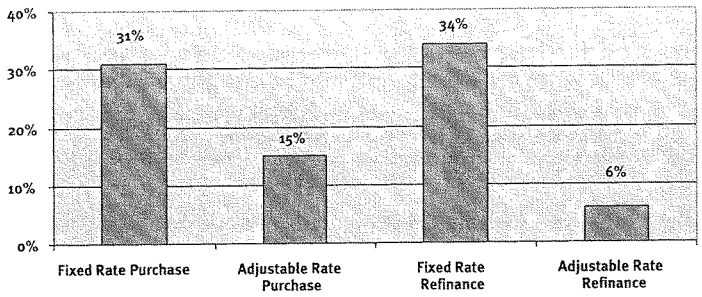
Our basic findings are outlined here:

1) **African-Americans were more likely to receive higher-rate home purchase and refinance loans than similarly-situated white borrowers, particularly for loans with prepayment penalties.**

- The effect of being an African-American borrower on the cost of credit was greatest for loans containing penalties for early payoff, which comprised over 60 percent of the loans we examined.

- As shown in the chart below, African-American borrowers with prepayment penalties on their subprime home loans were 6 to 34 percent more likely to receive a higher-rate loan than if they had been white borrowers with similar qualifications. Results varied depending on the type of interest rate (i.e., fixed or adjustable) and the purpose (refinance or purchase) of the loan.

Increased Likelihood that African-American Borrowers Received a Higher-Rate Subprime Loan with a Prepayment Penalty* versus Similarly-Situated White Borrowers

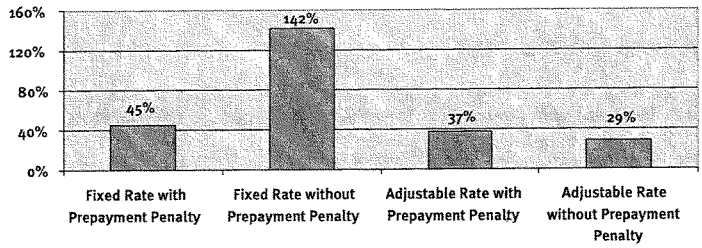


* During 2004, approximately two-thirds of all home loans in the subprime market had prepayment penalties.

2) Latino borrowers were more likely to receive higher-rate loans than similarly-situated non-Latino white borrowers for mortgages used to purchase homes. Differences for refinance loans were not significant at a 95 percent confidence level.

- Latino borrowers purchasing homes were 29 to 142 percent more likely to receive a higher-rate loan than if they had been non-Latino and white, depending on the type of interest rate and whether the loan contained a prepayment penalty.
- Pricing disparities between Latinos and non-Latino white borrowers for refinance loans were not significant at the 95 percent confidence level in our dataset.

Increased Likelihood that Latino Borrowers Received a Higher-Rate Subprime Purchase Loan versus Similarly-Situated White Borrowers



This analysis does not allow us to estimate precisely how much race and ethnicity increase the prices charged to borrowers. It is also beyond the scope of this paper to determine definitively why these disparities exist. However, we do posit several possible causes, including the considerable leeway mortgage originators have to impose charges beyond those justified by risk-based pricing.

A notable and pervasive example of discretionary pricing occurs through "yield-spread premiums," which are monetary incentives for mortgage brokers to inflate rates on subprime loans. Other causes of pricing disparities may include the inconsistent application of objective pricing criteria, targeting of families of color by higher-rate lenders or brokers, and lack of investment by lower-cost lenders in these communities. It is likely that all of these factors contribute to making subprime home loans more costly than necessary.

While these results are particularly disturbing for borrowers of color, the results have negative implications for all borrowers in the subprime market, since common business practices such as discretionary pricing can affect anyone.

For African-Americans, the most striking disparities that emerged in our research were associated with prepayment penalties; for Latinos, the greatest disparities related to loan type (purchase versus refinance). Examining these differences, we discuss several hypotheses. First, we believe the larger disparities observed for African-Americans in subprime loans with prepayment penalties may be related to yield-spread premiums, since lenders are often more willing to pay these premiums on loans that include prepayment penalties. Mortgage originators routinely make exceptions to guidelines, but it may be that African-Americans receive fewer favorable exceptions than white borrowers. Second, we believe that the disparities evidenced for Latinos on purchase mortgages might arise from a greater concentration of recent immigrants among this borrower pool. If so, the higher disparities in the purchase market may be a result of higher-cost lenders targeting recent immigrants.

While these results are particularly disturbing for borrowers of color, the results have negative implications for all borrowers in the subprime market, since common business practices such as discretionary pricing can affect anyone. The cost of mortgages matters more than the cost of typical consumer goods. Whether or not families receive fairly priced home loans is a major factor in their fundamental financial security. Higher loan costs will both dissuade some potential borrowers from investing in homeownership and increase the risk of foreclosure for those who do.

Lenders and policymakers can take a number of constructive actions to help ensure more equitable pricing for all borrowers. These include:

- Curtailing steering by requiring objective pricing standards;
- Holding lenders and brokers responsible for providing loans that are suitable for their customers;
- Amending HMDA to expand the disclosure requirements for risk and pricing information;
- Ensuring that adequate resources are dedicated to fully enforcing fair lending laws; and
- Creating incentives and supporting a policy framework that lead the market to better serve African-American and Latino communities.

II. BACKGROUND

A. HMDA

In 1975, Congress enacted the Home Mortgage Disclosure Act (HMDA). HMDA was a legislative response to the widespread practice of mortgage "redlining," that is, the systematic exclusion of neighborhoods of color when marketing or originating home loans.[1] Shortly thereafter, Congress passed the Community Reinvestment Act (CRA) to encourage lending in previously neglected communities,[2] and amended the Equal Credit Opportunity Act (ECOA), to prohibit discrimination based on race and national origin, among other criteria.[3] While CRA mandated that financial institutions help meet the credit needs of their entire communities and ECOA outlawed discrimination in the extension of financial credit, the original HMDA aided in the implementation of both laws by requiring regulated institutions to disclose summaries of their mortgage lending by census tracts.

These laws focused on access to credit, and they were enacted during a time when there was less concern about discriminatory disparities in mortgage pricing, partly because nearly all states had regulatory limits on interest rates and points charged for mortgages. That situation changed in 1980 with the passage of the Depository Institutions Deregulation and Monetary Control Act (DIDMCA), which preempted state laws governing interest rates and points on first-lien loans unless states explicitly chose to opt out of the law.[4] By deregulating most mortgage lending, DIDMCA laid the groundwork for a high-priced subprime mortgage refinance market, and resulted in a market segment with a much wider range of loan prices than was found in the prime market.[5]

Meanwhile, disclosure requirements under HMDA have evolved over time to reflect the changing nature of mortgage lending and discriminatory practices, broadening both the range of lenders under its purview and the information those lenders are required to disclose.[6] Specifically, HMDA's scope has expanded to encompass non-depository institutions, such as mortgage companies, which have significantly increased their share of the mortgage market over the past three decades. In addition, the disclosure requirements of lenders have evolved to include a wide range of loan application data on loan approval decisions, borrower demographics, and property characteristics.[7]

One of the most important changes to HMDA is the recent inclusion of limited pricing information related to the annual percentage rate (APR) of certain loans.[8] For loans originated in 2004, lenders were required to report the spread between the APR of designated loans and the yield on a U.S. Treasury security of comparable maturity. Specifically, lenders submitted this information on first-lien loans if the spread was at or above three percentage points, and they submitted this information on subordinate liens if the spread was at least five points. Throughout this paper, we refer to loans with APRs high enough to require the disclosure of this spread as "higher-rate" loans.

This information on higher-rate loans makes it possible for the first time to use HMDA not just to detect disparities in loan dispositions (i.e., the proportion of loans that were approved or denied) between demographic groups, but also differences in loan pricing.[9] Since borrowers can be vulnerable to discrimination at both the underwriting and pricing stages of the loan process, the ability to detect discriminatory patterns in both areas is critical for ensuring that all racial and ethnic communities have an equal opportunity to build home equity.

Select HMDA Studies on Racial and Ethnic Disparities in Mortgage Lending

Though analyses of mortgage pricing based on HMDA data have not been possible prior to the release of the 2004 data, many studies have examined HMDA data to evaluate other issues related to possible inequities in the mortgage market. Such studies have tended to focus on differences in loan disposition (i.e., whether loan applications have been approved or denied) by race and ethnicity or on whether certain groups are disproportionately served by subprime lenders.

1) Impact of Race and Ethnicity on Loan Decisions

Because HMDA has long been the primary source of public information on loan applications and underwriting decisions, it has been used extensively to analyze whether certain groups of borrowers are more or less likely to have their application for a home loan denied. The most famous research of this kind was published in 1996 by the Federal Reserve Bank of Boston, "Mortgage Lending in Boston: Interpreting HMDA Data," often referred to simply as the "Boston Fed Study."[10] This study combined publicly-available HMDA data from the Boston area with a number of additional variables, including information on credit history collected from area lenders. The study found that the risk of loan denial for African-Americans and Latinos was about 80 percent greater than that of white applicants, controlling for a host of applicant, loan, property, and neighborhood characteristics.[11]

2) Impact of Race and Ethnicity on Loan Originations

Several studies have used HMDA data to analyze whether specific racial and ethnic groups receive a disproportionate share of subprime loans. Because HMDA data does not specifically identify subprime loans, most of these studies have approximated which loans were subprime by using annual lists of predominately subprime lenders published by the U.S. Department of Housing and Urban Development (HUD).

A 2000 joint report by HUD and the U.S. Department of Treasury explored the relationship between subprime lending and neighborhood racial composition.[12] Relying on HMDA data, the study reported that subprime lending accounted for 51 percent of all refinance loans in predominately African-American communities in 1998, compared to only nine percent in predominately white neighborhoods. The study also found that these disparities persisted even when controlling for neighborhood income.

A 2002 national study by the Center for Community Change analyzed the proportion of borrowers receiving subprime refinance loans by race and ethnicity and found pervasive disparities among African-American, Latino and white borrowers.[13] In addition, the authors found that disparities persisted within income categories and actually increased as income went up. Specifically, while lower-income African-American borrowers were 2.4 times as likely to receive a loan from a subprime lender as lower-income white borrowers, upper-income African-American borrowers were 3.0 times as likely to receive such loans as upper-income white borrowers. At the same time, lower-income Latino borrowers were 1.4 times as likely to receive a subprime loan as lower-income white borrowers, and upper-income Latinos were 2.2 times as likely to receive such loans as upper-income whites.

In "The Neighborhood Distribution of Subprime Mortgage Lending," Paul Calem, Kevin Gillen and Susan Wachter controlled for variables included in HMDA data as well as census tract-level risk information to evaluate the effect of borrower race and neighborhood racial composition on receiving subprime loans in Chicago and Philadelphia.[14] Specifically, the authors combined HMDA data with variables such as foreclosure rates and information on the credit scores of the tracts' populations and found that both the race of individual borrowers and neighborhood racial composition have statistically-significant impacts on the likelihood of receiving a loan from a subprime lender, even after controlling for the borrower information available in HMDA and tract-level risk factors.

B. The 2004 HMDA Data: Pricing Disparities Surface

In September 2005, the Federal Financial Institutions Examination Council (FFIEC) released the 2004 data for all HMDA reporters in electronic form, making it possible to analyze the entire U.S. mortgage market.[15] The release of this data has contributed valuable information to the debate on whether the mortgage market extends credit equally and fairly to borrowers of all races and ethnicities. Organizations such as the National Community Reinvestment Coalition (NCRC), the Association of Community Organizations for Reform Now (ACORN), and the Consumer Federation of America (CFA) have pointed to the existence of large disparity ratios (i.e., the ratios between the proportion of borrowers of color that received higher-rate loans to the proportion of whites receiving such loans) as potential evidence of unfair pricing.[16] Others have dismissed such claims, asserting that raw disparity ratios are meaningless since they do not control for differences in legitimate risk factors, such as credit histories and loan-to-value ratios, among different racial and ethnic groups.[17]

The most comprehensive analysis of the 2004 HMDA data to date, conducted by staff to the Board of Governors of the Federal Reserve System (Fed), found that pricing disparities persist even after controlling for borrower-specific information such as income, origination amount, gender, property location and presence of a co-applicant.[18] In "New Information Reported Under HMDA and Its Implication for Fair Lending Enforcement," the Fed authors first confirmed the existence of large raw disparities between the proportion of African-American and Hispanic white borrowers receiving higher-rate loans to that of non-Hispanic white borrowers in both the home purchase and refinance markets.[19]

The Fed authors next made a series of adjustments to account for differences between white borrowers and borrowers of color by controlling for the following demographic information contained in HMDA data: borrower income, loan amount, location (MSA) of the property, presence of a co-applicant, and gender. Essentially, these adjustments estimated the portion of loans to African-American and Hispanic borrowers that would be expected to be higher-rate if, on average, the observed borrower traits were the same for these borrowers as for non-Hispanic white borrowers. These adjustments lowered observed disparity ratios between borrowers of color and whites by seven to 17 percent, but large disparities still existed.[20] The authors also adjusted for differences in lender composition between the groups. This second set of adjustments estimated the proportion of loans to African-Americans and Hispanic white borrowers that would be expected to be higher rate if the distribution of these loans among individual lenders were the same as the distribution of loans for non-Hispanic white borrowers. Interestingly, these "lender adjustments" reduced the disparity ratios considerably, though significant differences remained.[21]

Table 1. Federal Reserve Evaluation of the Disparities in the Incidence of Higher-Rate Loans* for Site-Built Properties: Black and White Hispanic Borrowers vs. Non-Hispanic White Borrowers

Borrower Race/ Ethnicity	Loan Purpose	Raw Disparity Ratio	Disparity Ratio Controlling for HMDA Borrower Characteristics	Disparity Ratio Controlling for HMDA Borrower Characteristics Plus Originating Lender
Black/African-American	Purchase	3.7	3.1	1.4
Black/African-American	Refinance	2.7	2.3	1.8
Hispanic or Latino	Purchase	2.3	1.9	1.3
Hispanic or Latino	Refinance	1.5	1.4	1.1

* Here we summarize findings only for conventional, owner-occupied, first-lien mortgages.
Source: Avery et al. (see note 18), Table 10.

However, the Fed's analysis of HMDA data did not control for several important risk factors, such as credit scores or loan-to-value ratios (LTVs), since these variables are not part of HMDA's disclosure requirements. The paper does, however, present partial results from an analysis conducted by the Credit Research Center (CRC). CRC analyzed data, including FICO scores and LTVs, from eight subprime lenders and found little disparity between the proportions of borrowers of different races and ethnicities getting higher-rate loans, seemingly in contrast with findings presented later in this paper. However, the Fed's paper does not fully explain CRC's methodology, and the data is likely limited in ways that make it of questionable value in understanding the disparity ratios in HMDA data and broader patterns in the subprime market. For more information about the CRC study, see Appendix 1.

Our analysis adds significantly to this body of research by supplementing HMDA data with information from a proprietary database. By combining information from each of these two datasets, we were able to incorporate important risk factors into a multivariate analysis of mortgage pricing.

III. A MORE IN-DEPTH LOOK AT PRICING DISPARITIES

A. Data

To include additional information on risk factors that might account for higher prices charged to African-American and Latino borrowers, we combined the 2004 HMDA data with a large, proprietary database of subprime loans. Like HMDA data, the other database contains specific information on individual loans, including borrower and property characteristics. Several types of information can be found in both datasets, including data on the location of the property, the originating lender, lien status, loan purpose, property type, and loan amount.

However, each dataset contains some information that the other does not. For example, the proprietary database includes critical pieces of information on loan risk at origination that are not included in HMDA, such as the LTV, credit score (FICO), and whether the loan was covered by private mortgage insurance. On the other hand, HMDA contains information on the race and ethnicity of borrowers. In addition, while HMDA contains information on APR spreads (which incorporates information on certain fees), the proprietary database has information on the mortgage note rate and whether the loan includes a prepayment penalty, but no information on APRs or up-front fees. (See Appendix 5 for information about the limitations of APR.) Finally, while the proprietary database we use is among the largest subprime home loan datasets available, accounting for an estimated 87 percent of U.S. subprime originations in 2004,[22] it only contains securitized subprime loans. For its part, the HMDA dataset is the single largest publicly-available dataset on U.S. mortgage originations, and it includes both prime and subprime loans for covered lenders.

Using information common to both HMDA and the proprietary database, we were able to match loans from the two databases, creating a new dataset of 177,487 subprime loans originated in 2004.[23] This merged dataset includes individual loan information on borrower characteristics (race, ethnicity, income, FICO credit score, income documentation level); loan characteristics (LTV, loan amount, purpose, existence and duration of prepayment penalties); property characteristics (location, property type); and pricing (APR spread for higher-rate loans).[24] To complement this loan-level data, we added publicly-available information on prevailing interest rates and state-specific information on housing prices, demographics and state judicial foreclosure and deficiency judgment laws.[25]

Using this combined dataset, we first examined the distribution of first-lien subprime loans that carried APRs above the three-percentage-point HMDA rate-reporting threshold ("higher-rate" loans). More specifically, we tabulated raw disparity ratios by categories of LTV and credit score. ("Disparity ratios" are the proportions of higher-rate loans received by borrowers of color divided by those of white borrowers.) This allowed for a simple analysis of whether overall disparity ratios might be attributable to differences in the LTV and credit scores between racial and ethnic groups.

A note on racial and ethnic designation:

The HMDA data allows borrowers to report both an ethnicity designation (either "Hispanic or Latino" or "Not Hispanic or Latino") and up to five racial designations (including both "white" and "African-American or Black"). To simplify notation and serve our research purposes, we coded and refer to any borrower who was identified as "Hispanic or Latino" as "Latino," and any borrower who was identified as "African-American or Black" in any of the race fields as "African-American." We coded borrowers and refer to them as "white" if they were associated with "Not Hispanic or Latino" and only identified as "white" in the race fields. The remaining loans were not coded into racial or ethnic categories and were excluded from the analysis. In practice, the Latino and African-American categories are not mutually exclusive, but the overlap in our merged dataset is small (about two percent), and using this method ensures maximum inclusion for members of each group.

Tables 2 and 3 show disparity ratios for African-American and Latino borrowers versus white borrowers. For African-Americans, disparity ratios in every LTV/FICO category exceeded one, while for Latinos disparity ratios exceeded one in the majority of categories. For example, for home purchasers with credit scores of 680 or higher and loan-to-value ratios of 90 percent or higher, disparity ratios for Latinos and African-Americans were 1.28 and 1.37, respectively. In other words, Latinos and African-Americans were 28 percent and 37 percent more likely, respectively, to receive a higher-rate subprime loan than whites.

We note that the disparities listed in Tables 2 and 3 differ from the Fed's results listed in Table 1 for at least two reasons. First, we are making a somewhat different comparison. While the Fed calculations use the proportion of higher-rate loans to all other loans for each group, Figures 2 and 3 use the proportion of higher-rate loans to all other subprime loans. In other words, while the Fed was able to look at pricing disparities across the entire market, data limitations require us to focus on disparities within the subprime sector. Second, Tables 2 and 3 group loans into combinations of FICO credit score and LTV, which effectively introduces a measure of control for risk.

Table 2. Subprime Purchase Loan Disparity Ratios by LTV/FICO Combination

LTV Percent	FICO Range	Borrower Race/Ethnicity	Number of Observations	Proportion of Loans that are High Cost	Disparity Ratio (vs. White Borrowers)
Less than 80	Less than620	African-American	326	64.4	1.20
		Latino	339	54.9	1.03
		White	1,279	53.1	NA
	620-679	African-American	152	30.9	1.53
		Latino	289	27.0	1.34
		White	847	20.2	NA
	680+	African-American	101	8.9	1.65
		Latino	358	13.4	2.50
		White	1,515	5.4	NA
80-89	Less than 620	African-American	1,700	62.6	1.26
		Latino	1,309	46.5	0.94
		White	4,223	49.7	NA
	620-679	African-American	1,351	35.7	1.60
		Latino	2,783	25.7	1.12
		White	5,483	22.9	NA
	680+	African-American	731	21.34	2.85
		Latino	2,615	14.5	1.93
		White	5,900	7.5	NA
90+	Less than 620	African-American	2,351	83.7	1.06
		Latino	1,709	75.7	0.96
		White	5,001	79.0	NA
	620-679	African-American	2,004	67.4	1.15
		Latino	3,115	59.8	1.02
		White	6,382	58.5	NA
	680+	African-American	931	46.8	1.37
		Latino	2,372	43.8	1.28
		White	3,936	34.1	NA

Table 3. Subprime Refinance Loan Disparity Ratios by LTV/FICO Combination

LTV Percent	FICO Range	Borrower Race/Ethnicity	Number of Observations	Proportion of Loans that are High Cost	Disparity Ratio (vs. White Borrowers)
Less than 80	Less than 620	African-American	2,904	62.8	1.05
		Latino	2,973	56.8	0.95
		White	12,314	59.6	NA
	620-679	African-American	731	20.0	1.18
		Latino	1,303	16.0	0.94
		White	4,957	17.0	NA
	680+	African-American	316	8.5	2.24
		Latino	976	5.3	1.39
		White	4,055	3.8	NA
80-89	Less than 620	African-American	2,496	68.4	1.11
		Latino	2,021	58.2	0.95
		White	9,365	61.5	NA
	620-679	African-American	818	27.5	1.22
		Latino	1,205	22.3	0.99
		White	4,808	22.6	NA
	680+	African-American	252	14.3	1.70
		Latino	586	8.5	1.01
		White	2,007	8.4	NA
90+	Less than 620	African-American	1,481	71.8	1.05
		Latino	977	63.2	0.93
		White	5,319	68.1	NA
	620-679	African-American	1,159	51.9	1.17
		Latino	1,219	45.1	1.02
		White	4,858	44.2	NA
	680+	African-American	264	29.6	1.21
		Latino	455	31.7	1.30
		White	1,557	24.4	NA

Because disparities between racial and ethnic groups persisted within a majority of LTV-FICO combinations, the results suggested the need for a more in-depth approach to determine how much conventional risk factors explain pricing variations between groups.

B. Statistical Analysis

Our statistical analysis adapts a mortgage pricing model created by Brent Ambrose, Michael LaCour-Little and Anthony Sanders in their study, "The Effect of Conforming Loan Status on Mortgage yield-spreads: A Loan Level Analysis."[26] In that study, the authors examined whether conforming to the conventional loan guidelines set by Fannie Mae and Freddie Mac had an impact on mortgage prices. Although our purpose is different and, consequently, the specific variables that we analyze are not identical to those included in their study, we adapted their general analytical approach.

Like Ambrose et al., we used multiple regression analysis to estimate the impact of different borrower, property, loan and geographic factors on the APR spread of a loan. Multiple regression allows the effect of individual factors (the "independent variables") on an outcome of interest (the "dependent variable") to be isolated from the effect of all other independent variables included in the models. In our case, we were interested in separating the effect of race and ethnicity on APR spreads from the effect of genuine risk factors such as LTVs and credit scores. However, whereas Ambrose et al. had the actual APR spread for all of the loans in their database, we only have the spread for those loans that exceeded HMDA's APR spread-reporting threshold. As a result, while the Ambrose study was able to use regression analysis to estimate the actual APR spread, our analysis allowed us to compare

the odds and likelihoods of different racial and ethnic groups receiving higher-rate loans, but did not allow us to estimate the magnitude of differences in APR spreads themselves.

To examine the effects of race and ethnicity, we conducted two distinct analyses. First, we used an initial "base" logistical regression model to estimate how much borrowers' race or ethnicity affected whether their loans were higher-rate, holding constant a host of borrower, property, loan, and geographic independent variables. However, logistic regression procedures assume that there is no "reverse-causation" between the dependent and independent variables. In other words, this method assumes that, while the independent variables may affect the dependent variable, the reverse is not true. We recognize that this assumption may not be valid in our case since a loan's APR may affect some of the variables we hold constant, namely LTV, loan amount, and whether the loan carried a prepayment penalty. For example, a borrower's decision to borrow a certain dollar amount might be, in part, based on the rate quoted. Therefore, like the Ambrose study, our final analysis includes statistical adjustments to account for the possible interdependence of these variables, providing a more reliable estimate of the effect of race and ethnicity on the risk of receiving a higher-rate loan.

1. The Base Model

As mentioned above, we first conducted logistic regressions to estimate whether race and ethnicity affected the risk of receiving a higher-rate loan. Table 4, below, lists the specific variables that were included in this base model.

Table 4. Logistical Specification for Base Model

Dependent Variable	**Variable Description**
HMDA_Threshold	Dummy variable=1 if APR spread is reported in HMDA, else=0
Independent Variables	
Borrower Characteristics	
BLACK	Dummy variable =1 if the borrower is African-American, else=0
LATINO	Dummy variable =1 if the borrower is Latino, else=0
MONTHLY INCOME	Monthly income, in dollars
FICO[27]	FICO credit score
FULL_DOC	Dummy variable=1 if the borrower provided full documentation of income, else=0
Loan/Property Characteristics	
LTV	Loan-to-value ratio at origination
ORIG_AMT	Loan origination amount, in dollars
PREPAY	Dummy variable=1 if the loan carries a prepayment penalty, else=0
MULTI	Dummy variable=1 if the loan is secured by a property with 2-4 units, else=0
CONDO	Dummy variable=1 if the loan is secured by a condominium, else=0
AGENCY CODES[28]	Categorical dummy variables representing the regulatory agency of the originating lender
Economic Variables:	
CREDIT_SPREAD	Monthly difference between AAA and Baa bond yields
YIELD_CURVE	Monthly difference between 10-year and 1-year Treasury yields
HPI_VOL	8 quarter standard deviation in the OFHEO state Housing Price Index
RATE_VOL	15 month standard deviation in 1-year Treasury yield
Q2-Q4	Categorical dummy variables for the second, third and fourth quarters of 2004
Geographic Variables:	
CDIV2-CDIV9	Categorical dummy variables for the Census division in which the property is located
STATELAW2-STATELAW4	Categorical dummy variables for state laws created by Ambrose et al. based on rules pertaining to judicial foreclosure and deficiency judgment
N_CCITY	Dummy variable=1 if the property is located in an MSA but outside of a central city, else=0
RURAL	Dummy variable=1 if the property is located outside an MSA, else=0
BLACK_STATE	Proportion of state population that is African-American
LATINO_STATE	Proportion of state population that is Latino

2. Expanded Model: Final Analysis

Our final model used more sophisticated techniques to analyze the same variables while accounting for potential interdependence of APR and some of the independent variables. Appendix 4 explains our methodology in more detail, but in the simplest terms, this model removed statistical problems that might be caused by reverse causation (i.e., two-way effects) between a loan's price and LTV, origination amount, and the existence of a prepayment penalty.

3. Analyses for Different Loan Categories

Recognizing that loan prices may depend in part on the type of interest rate (adjustable or fixed) and/or the loan purpose (purchase or refinance), we performed all analyses separately for each of the following four loan categories: 1) Purchase fixed-rate mortgages (FRMs); 2) Purchase adjustable-rate mortgages (ARMs); 3) Refinance FRMs; and 4) Refinance ARMs. In addition, to limit variations in loan products within each category, we included only the dominant types of ARM and fixed-rate loans.[29]

Specifically, our analysis of ARM loans included only 2/28 hybrid ARMs (loans with a fixed interest rate for two years followed by a 28-year term with semi-annual interest rate adjustments calculated by adding a margin to an index based on six-month LIBOR rates), with either no prepayment penalty or a prepayment penalty of two years. Our analysis of fixed-rate mortgages included all 30-year loans, with either no prepayment penalty or a prepayment penalty with a term of three years.[30] All analyses were further restricted to loans secured by first-liens on owner-occupied, single-family properties. Finally, we also excluded loans secured by manufactured housing units, those backed by private mortgage insurance, those with non-standard amortization schedules, and those with origination amounts exceeding the jumbo loan thresholds.[31]

4. Presentation of Findings: Odds and Likelihoods

When using logistic regressions to predict whether an event will happen or not, it is conventional to express the results in terms of "odds ratios." In this case, we are essentially trying to understand whether race or ethnicity help explain whether a borrower receives a higher-rate home loan, even after controlling for conventionally accepted risk factors. Odds ratios are simply the odds of one group receiving a higher-rate loan divided by the odds of a reference group. (In our case, the reference group is similarly-situated white borrowers.)

Odds ratios include two important features: magnitude and significance. The magnitude is simply the value of the ratio. An odds ratio of 1.0 indicates there is no disparity. A ratio above 1.0 indicates that, for instance, the odds of getting a higher-rate loan were greater for African-American and Latino borrowers than the odds for similar white borrowers, while a ratio under 1.0 indicates that the odds for these groups was lower than for white borrowers. For example, if the odds ratio between African-American borrowers and white borrowers is 1.3, it means that the odds of an African-American borrower receiving a higher-rate loan is 30 percent greater than the odds for a similarly-situated white borrower. If, however, the odds ratio were 0.7, the odds of an African-American borrower receiving a higher-rate loan would be 30 percent lower than that of a similarly-situated white borrower. The significance shows whether an odds ratio was different from 1.0 by a statistically-significant amount. Statistical significance is the conventional method in social science research for judging whether observed differences represent meaningful disparities or are the result of random variation.

While odds ratios are conventionally used when presenting information from logistic regressions,[32] it is often more intuitive to think in terms of probabilities or likelihoods. Therefore, we used the information from our models to predict the likelihoods that the African-American and Latino borrowers in our dataset received a higher-rate loan and compared that to the expected likelihood if those same borrowers had been white. By comparing these two predicted probabilities, which are estimated based on identical risk factors between groups, we were able to isolate the effect of race and ethnicity on the likelihood of receiving a higher-rate loan for borrowers in our dataset. See Appendix 7 for a more detailed explanation of odds and likelihoods.

5. Limitations

Like all statistical analyses, the study presented here has limitations. First, APR spread is an imperfect measure for examining pricing data, since it essentially blends interest rates with points and fees in a way that assumes that borrowers will keep the loan for its entire term and, consequently, it tends to underemphasize costs arising from fees.[33] However, in the context of this study, it is unlikely this limitation would undercut our basic findings, since it is unlikely that preferences for fee-rate tradeoffs systematically vary by race or ethnicity in ways that are uncorrelated with credit score, income, LTV, or other factors already included in our analysis. Moreover, to the extent that borrowers of color are targeted for high-fee predatory lending,[34] such patterns would tend to lead to underestimated pricing disparities between these borrowers and white borrowers since, again, APR tends to minimize the costs of fees.[35]

Second, because HMDA only provides APR-spread information for higher-rate loans, our analysis is limited to comparing the relative odds and likelihoods of receiving these higher-rate loans. Unlike Ambrose et al., we did not estimate the magnitude of the differences in APRs between loans.

Third, unlike the Fed study, our database was not large enough to control for metropolitan statistical area or for individual lenders. However, our analysis does account for general correlations between APR, on the one hand, and location, race, and ethnicity on the other by controlling for state housing prices, census regions, state laws regarding judicial foreclosure and deficiency judgment and state racial and ethnic compositions. In addition, by including regulating agencies as independent variables, we essentially control for lender type.

Fourth, since our merged data only contains subprime loans, this analysis neither allows for an evaluation of pricing disparities that includes the prime market, nor provides any insight into how different borrowers end up with prime rather than subprime lenders.

Finally, our models may omit information that is correlated with both APR and the race and ethnicity of borrowers (e.g., employment tenure). Though we were able to control for the majority of risk-based characteristics that lenders generally use to price loans, at least according to rate sheets, it is nevertheless possible that omitted variables could influence our results. This limitation applies to virtually all empirical social science research.

IV. FINDINGS

First, we note that—apart from the findings for race and ethnicity—the results for our explanatory variables were consistent with rational risk-based pricing practices in the mortgage industry. For example, coefficients on LTV were consistently positive and significant, showing that higher LTVs increase the likelihood of receiving a higher-rate loan. Also, estimates on credit scores were negative and significant, showing that borrowers with lower credit scores were also more likely to receive higher-rate loans. We also note that our models did a good job overall of predicting whether borrowers would receive a higher-rate loan. Appendix 6 presents the full results, including model-fit statistics for all models.

African-American borrowers were 31 percent more likely to receive a higher-rate loan on fixed-rate purchases.

In general, our analyses show that race and ethnicity were significant factors in determining whether borrowers received higher-rate home loans. That is, African-American and Latino borrowers were more likely to receive higher-rate loans than white borrowers with similar risk factors for many categories of subprime loans. The significance of race was particularly consistent for loans with prepayment penalties, while the impact of ethnicity was concentrated in loans for home purchases.

A. Effect of Race on Subprime Loan Pricing

1. Purchase Loans: Our estimates show that race had a significant effect on the risk of receiving a higher-rate loan for most fixed-rate and all adjustable-rate subprime purchase mortgages. Specifically:

• Fixed-Rate Purchase Loans:
Our base model estimated that the odds of receiving a higher-rate, fixed-rate purchase loan for African Americans were 71 percent greater than for whites. In our final model, the increase in the odds for African-American borrowers on loans without prepayment penalties continued to be positive, but was no longer significant at a 95 percent confidence level. However, for the more than 60 percent of fixed-rate purchase loans that did contain prepayment penalties, the increase in odds for African-American borrowers rose to 84 percent and was statistically-significant. Based on our likelihood simulation, we estimated that these African-American borrowers were 31 percent more likely to receive a higher-rate loan than if they had been white borrowers.*

Table 5. Effect of Race on Risk of Receiving a Higher-Rate Subprime Purchase Loan (African-American vs. White)

Models		FRMs			ARMs		
		Number of Observations	Odds Ratio	Increased Likelihood	Number of Observations	Odds Ratio	Increased Likelihood
Base Model	**All Loans**	3,679	**1.71**	**28.7%**	17,978	**1.24**	**9.0%**
Final Model	**Loans without Prepayment Penalties**	1,444	1.64	30.9%	4,657	**1.40**	**16.3%**
	Loans with Prepayment Penalties	2,235	**1.84**	**30.8%**	13,321	**1.41**	**15.3%**

*Bolded results are statistically significant at a 95 percent confidence level.

• Adjustable-Rate Purchase Loans: Both the base and final models estimated that African-Americans were more likely to receive a higher-rate adjustable rate purchase loan than similarly-situated whites. The base model estimated that the odds for African-Americans were 24 percent higher than for whites. In our final model, the increase in odds rose to 40 percent for loans without prepayment penalties and 41 percent for loans with prepayment penalties, both of which were statistically significant. Translated into likelihoods, African-Americans in our sample were 15 to 16 percent more likely to receive a higher-rate ARM purchase loan than if they had been white.

2. Refinance Loans: Our base model estimated that race had a positive and significant effect on the likelihood of receiving a higher-rate loan for all fixed-rate and adjustable-rate subprime refinance loans. In our final model, the increased odds persisted for loans with prepayment penalties.

• Fixed-Rate Refinance Loans: Our base model estimated that the odds of an African-American borrower receiving a higher-rate fixed-rate refinance loan were 44 percent greater than for a similarly-situated white borrower. Our final model showed that, for fixed-rate refinance loans without prepayment penalties, the impact of race was not detectable at a 95 percent confidence level. However, over two-thirds of fixed-rate refinance loans did have prepayment penalties, and our final model estimated that the odds of African-American borrowers with these loans receiving a higher-rate were 62 percent higher than for white borrowers. Translated into relative likelihoods, these African-American borrowers were 34 percent more likely to receive a higher-rate loan than if they had been white.

Table 6. Effect of Race on Risk of Receiving a Higher-Rate Subprime Refinance Loan (African-American vs. White)

Models		FRMs			ARMs		
		Number of Observations	Odds Ratio	Increased Likelihood	Number of Observations	Odds Ratio	Increased Likelihood
Base Model	**All Loans**	8,799	**1.44**	**22.9%**	18,470	**1.16**	**5.6%**
Final Model	**Loans without Prepayment Penalties**	2,881	1.24	11.2%	6,520	1.04	1.2%
	Loans with Prepayment Penalties	5,918	**1.62**	**34.3%**	11,950	**1.17**	**6.1%**

*Bolded results are statistically significant at a 95 percent confidence level.

• Adjustable-Rate Refinance Loans: Our base model estimated that the odds of an African-American borrower receiving a higher-rate adjustable-rate refinance loan were 16 percent greater than for a similarly-situated white borrower. Again, our final model showed different results for loans with and without prepayment penalties. Specifically, the final model showed a small and positive difference between African-Americans and whites in loans without prepayment penalties (only 35 percent of adjustable-rate subprime refinance loans in our analysis), though one that is not significant at a 95 percent confidence level. However, for the 65 percent of ARM refinance loans that do have prepayment penalties, the final model estimated that the odds of an African-American borrower receiving a higher-rate loan were 17 percent higher than the odds for a white borrower with similar risk features. Our likelihood simulation estimated that these borrowers were six percent more likely to receive higher-rate loans than if they had been white.

B. Effect of Ethnicity on Subprime Loan Pricing

1. Purchase Loans: All final model results showed that Latino borrowers were more likely to receive higher-rate subprime purchase loans than white borrowers.

• Fixed-Rate Purchase Loans: The base model estimated that the odds of a Latino borrower receiving a higher-rate, fixed-rate purchase loan were 60 percent greater than a similarly-situated white borrower. In our final model, the increase in odds rose to 189 percent for loans without prepayment penalties and 71 percent for those with prepayment penalties. Translated into relative likelihoods, the final model suggested that Latino borrowers of fixed-rate purchase loans without prepayment penalties in our sample were 142 percent more likely to receive higher-rate loans than if they had been white. Latino borrowers of fixed-rate purchase loans with prepayment penalties in our sample were 45 percent more likely to receive higher-rate loans than if they had been white.

Latino borrowers of fixed-rate purchase loans with prepayment penalties in our sample were 45 percent more likely to receive higher-rate loans than if they had been white.

Table 7. Effect of Ethnicity on Receiving a Higher-Rate Subprime Purchase Loan (Latino vs. White)

Models		FRMs			ARMs		
		Number of Observations	Odds Ratio	Increased Likelihood	Number of Observations	Odds Ratio	Increased Likelihood
Base Model	**All Loans**	3,679	**1.60**	**39.6%**	17,978	1.06	3.6%
Final Model	**Loans without Prepayment Penalties**	1,444	**2.89**	**141.9%**	4,657	**1.52**	**28.6%**
	Loans with Prepayment Penalties	2,235	**1.71**	**44.6%**	13,321	**1.66**	**37.4%**

*Bolded results are statistically significant at a 95 percent confidence level.

• Adjustable-Rate Purchase Loans: The base model estimated that the odds of a Latino borrower receiving a higher-rate adjustable-rate purchase loan were not different at a 95 percent confidence interval from a similarly-situated white borrower. However, the final model indicated that the increased risk for Latino borrowers was, in fact, statistically significant. Specifically, the odds of Latino borrowers receiving a higher-rate on adjustable-rate purchase loans were 52 percent greater for loans with prepayment penalties and 66 percent greater for those without prepayment penalties than for similarly-situated whites. For our sample, Latino borrowers of ARM purchase loans with and without prepayment penalties were, respectively, 37 percent and 29 percent more likely to receive higher-rate loans than if they had been white.

2. Refinance Loans: Our models did not find evidence of an impact of ethnicity on loan prices in the refinance market at a 95 percent confidence level.

- Fixed-Rate and Adjustable-Rate Refinance Loans: Neither the base nor the final model found a difference in the odds of Latinos receiving a higher-rate subprime refinance loan compared to white non-Latino borrowers that was significant at a 95 percent confidence level. This was true both for fixed-rate and adjustable-rate subprime refinance loans.

V. DISCUSSION

The pricing disparities revealed by our results point to underlying market inefficiencies that have implications for all borrowers. While disparities highlight disadvantages faced by borrowers of color, this by no means suggests that the subprime market is delivering uniformly desirable or good outcomes for white borrowers. To the contrary, we believe that evidence of disparate pricing for borrowers of color is likely a symptom of a larger set of issues in a market that has gained notoriety as a magnet for predatory lenders. The point is further underscored by the scale of legal settlements related to widespread predatory lending by subprime lenders. For example, Household Finance entered a settlement agreement in 2002 for $484 million that stands as the largest consumer restitution agreement in U.S. history.[36] Sizeable settlements also have been entered into by Citigroup and, most recently, Ameriquest.[37]

We believe that evidence of disparate pricing for borrowers of color is likely a symptom of a larger set of issues in a market that has gained notoriety as a magnet for predatory lenders.

Efficient financial markets should provide similarly-situated borrowers with equally competitive prices on subprime home loans. In fact, subprime lenders construct complicated pricing matrices in the form of "rate sheets" in an effort to meet this challenge. These rate sheets describe how to calculate applicable interest rates from a borrower's credit score, the amount of equity held by the borrower in the home, and several other factors that measure risk. Lenders' internal fair lending compliance operations aim to ensure that these criteria are valid and not based on impermissible discriminatory factors. This investment is prudent, since lenders face serious legal and reputational risks if they violate fair lending standards.

Yet, in multiple analyses that control for the major factors lenders explicitly use to set prices, we find that borrowers' race and ethnicity continue to exert a statistically-significant influence on the cost of their subprime mortgages. For several types of loan products, borrowers of color in our database were more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in risk. Disparities tended to be larger for fixed-rate loans than for their adjustable-rate counterparts.

Our findings indicate that African-American and Latino borrowers face the highest risks for pricing disparities under different circumstances. Relative to white borrowers, African-American borrowers were at greatest risk of receiving a higher-rate loan when their subprime mortgage included a prepayment penalty. Specifically, African-American borrowers with prepayment penalties on their subprime home loans were 6 to 34 percent more likely to receive a higher-rate loan than similarly-situated white borrowers, depending on the type of interest rate (i.e., fixed or adjustable) and the purpose (refinance or purchase) of the loan. Latino borrowers were at greatest risk when they used their

For several types of loan products, borrowers of color in our database were more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in risk.

mortgage to purchase a home rather than to refinance an existing home loan. In these cases, they were 29 to 142 percent more likely to receive a higher-rate loan than similarly-situated white borrowers, depending on the type of interest rate and whether the loan contained a prepayment penalty.[38]

While no empirical analysis is without limitations,[39] the rich data used here, the stability of our findings in analyses that examine different combinations and forms of explanatory variables (see Appendix 6), and the consistency of findings across multiple product lines all indicate that the pricing disparities we identify are genuine and significant. What then could explain these results?

One explanation for the disparities could stem from differences in how individual lenders price loans. This explanation involves specific lenders charging borrowers of color rates that are higher than those charged similarly-situated white borrowers—i.e., "disparate loan pricing." In an alternative explanation, pricing disparities would be expected if borrowers of color disproportionately received their loans from lenders whose loans are generally priced higher than lenders that primarily serve white borrowers. For convenience, we generally refer to such a pattern as "market segmentation."

We stress that data was not available that would allow us to distinguish between these two underlying reasons or quantify their effects. However, given that both represent plausible factors, it is worthwhile to consider both scenarios in more detail:

A. Disparate Loan Pricing

While rate sheets do present objective pricing schedules for calculating a loan's interest rate, they are not definitive statements of a loan's price for a given borrower. Discretionary yield-spread premiums and other up-front charges, as well as negotiated exceptions to rate sheet guidelines, are common examples of how a loan's price can vary from prices displayed on a rate sheet. These variations could account for part or all of the differences in subprime loan pricing among white, African-American, and Latino borrowers.

1. Discretionary charges such as yield-spread premiums or other up-front charges are subjective elements that could lead to disparate pricing.

Frequently, mortgage originators adjust the interest rate on home loans without regard to any objective risk-based criteria. When these adjustments are used to increase the interest rate of a loan, they increase the value of the mortgage (also called the yield) to the lender. The difference between the new higher rate and the lowest rate for which the borrower qualified is called a "yield-spread." When a loan with an increased rate is sold to an investor or delivered by a broker to a lender, the investor or lender will pay a premium price for that loan. The difference between the price paid for this loan with an inflated interest rate and the price that would have been paid for the loan had the borrower received the lowest rate for which he or she qualified is called a yield-spread premium, or YSP for short.[40]

While YSPs theoretically can play a helpful role,[41] the exchange is a complicated one that is easily abused. Borrowers often wrongly assume or are misled into believing that mortgage brokers are working to find them the lowest-cost loan for which they qualify, even if they actually receive an over-priced or even predatory loan.[42] Even when borrowers are aware that brokers are not required to offer the best rate, determining whether a proposed loan carries a YSP, let alone performing the complex financial calculations necessary to compare prices across mortgages with and without YSPs, is surely overwhelming for many borrowers.[43]

We hypothesize that pricing disparities faced by African-American borrowers in the subprime market are at least partially driven by YSPs.

When YSPs are applied in ways that disparately affect borrowers in protected classes, including race and ethnicity, this form of discretionary pricing may carry serious fair lending implications. In fact, this is a prominent example of how borrowers may be "steered" into a higher-rate loan. In part, because of such concerns, a number of states have addressed YSPs in the context of predatory lending legislation.[44]

Unfortunately, it has been difficult to study the overall effects of YSPs. The precise amount paid in yield-spread premiums is disclosed only on the HUD-1/1A closing statement, which lenders must provide to borrowers. Though that information is generally unavailable to researchers, at least one researcher who has obtained copies of these documents has reached troubling conclusions. Examining loans from an affiliated set of lenders, Harvard Law School Professor Howell Jackson found that African-American and Latino borrowers paid mortgage brokers more for their services than other borrowers, and he hypothesizes that yield-spread premiums were at least partially responsible.[45]

Taking the results of Professor Jackson's research along with findings from this paper and previous research, we hypothesize that pricing disparities faced by African-American borrowers in the subprime market are at least partially driven by YSPs. On the one hand, we have the direct evidence from Professor Jackson and that is presented in this paper. On the other, we note that subprime lenders' rate sheets routinely stipulate that brokers can only maximize the amount of a YSP if the loan carries a prepayment penalty.[46] In practice, this linking of YSPs with prepayment penalties ensures that a lender will receive either extra-interest or penalty income sufficient to offset the up-front cash payment to a broker. Bocian and Zhai have previously shown that borrowers in communities of color were at greater risk of receiving a subprime loan with a prepayment penalty controlling for differences in credit quality, location, and property type.[47]

In addition to yield-spread premiums, non-interest up-front charges on home loans referred to as "points and fees" can vary over wide ranges.[48] Since the loan's APR reflects some (though not all) of these charges, variations in points and fees paid by borrowers of different races and ethnicities also may give rise to differences in APR spreads. Interestingly, recent research using some of the same data employed by Professor Jackson showed that borrowers paid the most when some of their brokers' compensation came from both yield-spread premiums and other up-front charges.[49] This evidence is consistent with brokers charging YSPs on top of, rather than in place of, other discretionary up-front fees.

2. Objective pricing criteria may be waived or modified disproportionately in favor of white borrowers.

Lenders appear to be under considerable pressure to deviate from objective pricing in order to secure loans originated by mortgage brokers. Accounting for an estimated 59 percent of subprime originations in 2005,[50] broker-originated mortgages comprise an important market segment. Lenders must compete against other lenders in the bid to provide loans to the large borrower base that obtain their mortgages from brokers. Available evidence suggests that the resulting pressure does indeed lead to exceptions to posted guidelines.

Select results from a recent survey of 2,400 mortgage brokers published by a leading industry trade publication suggested that the explicit discretion available to brokers in rate sheets may represent only part of subjective changes that occur in the pricing process.[51] In the survey, almost half (47 percent) of respondents said they dismissed rate sheets and automated pricing systems in favor of a phone call to determine the interest rate applicable to a loan. In addition, while the publication did not report specific statistics, it did affirm that brokers seek exceptions to the standard underwriting guidelines provided by lenders.

If such exceptions are made more for one group of borrowers than another, it would clearly have the potential to lead to disparate loan pricing between groups. This hypothesis is more than pure supposition. In closely related questions examined in matched-pair testing, Urban Institute researchers have found that borrowers of color received less favorable treatment in the mortgage application process.[52]

B. Market Segmentation

Borrowers of color also would be more likely to receive higher-rate subprime loans if they tended, on average, to receive their loans from lenders that generally charge more than the lenders predominately serving white borrowers. Such lenders might face a greater cost of funds, have higher overhead charges resulting from less streamlined operations, higher marketing expenses, or might simply demand greater returns.[53] While we generally expect that efficient markets will result in borrowers selecting for themselves loan options with the lowest costs,[54] substantial evidence, apart from the findings presented in this paper, exists to support the notion that borrowers are not finding their way to the best-priced home loan.[55] This section discusses three possible explanations for this pattern.

1. Higher-cost lenders may directly or indirectly target borrowers of color.

The most obvious explanation for why borrowers of color would disproportionately receive their loans from higher-rate lenders would be that higher-rate lenders target borrowers of color directly on the basis of race or ethnicity or indirectly on the basis of traits correlated with race or ethnicity. Some examples of the latter might include marketing targeted at borrowers living in certain geographic locations or who have education, wealth, unemployment rates, or other factors often associated with less financial sophistication.

Once identified, targeted borrowers who share these traits might be disproportionately subject to aggressive marketing techniques. In fact, William Apgar and Allegra Calder have noted that "even though mortgage loans are now readily available in low-income minority communities, by employing high-pressure sales practices and deceptive tactics, some mortgage brokers push minority borrowers into higher-cost subprime mortgages that are not well suited to their needs and can lead to

financial problems down the road." This observation is particularly troubling since it may be difficult even for an otherwise optimal market to correct such inefficiencies. That is, responsible lenders will be seriously challenged to compete for business in communities of color if unscrupulous lenders are using aggressive and deceptive tactics to persuade borrowers to accept their loans.[56]

Responsible lenders will be seriously challenged to compete for business in communities of color if unscrupulous lenders are using aggressive and deceptive tactics to persuade borrowers to accept their loans.

This sort of targeting might help explain the disparities observed among Latino borrowers in our dataset. We believe that the group of borrowers identified as Latino in HMDA data is broad, ranging from recent immigrants to fourth- or higher-generation Americans.[57] It might be the case, however, that Latinos who take a subprime mortgage to purchase a home are more likely to be recent immigrants. If so, the higher disparities we observe in the purchase market for Latinos may arise from the targeting of recent immigrants by higher-cost lenders. Under such a hypothesis, recent Latino immigrants might also face disparate outcomes in the refinance market that we are unable to capture since those results are blended with a broader Latino population.

Similarly, even if a lender is not directly involved in such targeting, it may be that mortgage brokers and other third parties involved in the transaction disproportionately refer borrowers to higher-cost lenders. Why? One explanation is that higher YSPs might motivate brokers to work with such lenders. Even if brokers or other third parties refer borrowers to lenders in a non-discriminatory way, if the brokers disproportionately serve borrowers of color and also disproportionately provide loans that cost more than retail loans, then borrowers of color would tend to get higher prices. As Apgar and Calder point out, this proposition is supported by empirical research:[58] A 2001 AARP survey of older borrowers found that 64 percent of African-American borrowers received their loan from a broker versus just 38 percent of white borrowers.[59] Also, Alexander et al. report that third-party subprime originations are more likely to default and that they therefore carry a higher rate than retail-originated loans.[60]

2. Relatively lower-cost subprime lenders might not compete aggressively for business in communities of color.

If brokers or other more expensive loan originators are disproportionately providing loans to borrowers of color, it is fair to ask whether lower-cost lenders are under-serving such customers. In this explanation, white borrowers receive disproportionately fewer higher-rate loans not because borrowers of color are targeted for such loans, but because the latter are excluded from lower-cost subprime loans. There is at least some anecdotal evidence that this problem continues to persist in the marketplace. For example, in 2004, the U.S. Department of Justice filed two cases against lenders for failing to lend in communities of color.[61]

The most potentially troubling hypothesis along these lines would be a scenario in which different affiliates of a lender essentially segmented their customers, with one disproportionately serving white borrowers with lower-cost subprime loans and the other marketing higher rates to communities of color. If this were the case, it is unclear whether the regulatory enforcement agencies have the infrastructure and resources necessary to detect and fully investigate such patterns.[62]

3. Higher-cost lenders may be more likely to flip borrowers.

A final possibility is that borrowers of color are no more likely to be served by higher-rate lenders than white borrowers—but are more likely to receive multiple loans within one year from a higher-rate lender. Because our dataset is comprised of loan transactions and not borrowers, we are unable to detect instances in which borrowers take multiple first-lien loans in a year. Loan flipping, where borrowers are repeatedly refinanced primarily for the purpose of generating income for the loan originators rather than for the benefit of the borrowers, has been identified as an important issue in the predatory lending context.[63] Recent research by Courchane, Surrette and Zorn indicates that borrowers' subsequent loans in the subprime market are explained in part by the market segment of their current loan: "We conclude, therefore, that previous mortgage segment is an important determinant of current market segment even after controlling for risk-related underwriting and demographic effects."[64] If rapid loan flipping (i.e., multiple loans within one calendar year) is concentrated in higher-rate subprime lenders, we note that it could contribute to the disparities we observe in refinance loans.

VI. POLICY RECOMMENDATIONS

Our research shows that, for most types of subprime mortgages, borrowers of color are more likely to receive higher-rate loans, and objective risk factors fail to explain the disparities. We have discussed several reasons that could explain this phenomenon related, broadly, to disparate loan pricing and the possible effects of market segmentation. It is likely that all of the factors discussed play some role in making subprime home loans more costly than necessary for people of color. In addition, the business practices that support excessive charges could apply equally to individual white borrowers in the subprime market who may lack the bargaining ability or financial experience to fully protect themselves.

Given the importance of wealth-building to all Americans, and the current wealth gap that exists between white Americans and communities of color,[65] these pricing disparities in the subprime market call for reform in the mortgage market. To encourage fair pricing of home loans that is based only on legitimate risk factors and facilitates economic progress for all borrowers, we recommend the following:

1. **Curtail steering by requiring objective pricing standards.**

Today, through advances in technology, lenders have a stronger ability than ever to apply risk-based pricing. Increasing the fairness and objectivity of the subprime home loan origination process would significantly improve outcomes for all families. Given the many explicit ways that American public policy supports homeownership, it is especially important that borrowers representing equivalent risks receive similar treatment from mortgage professionals. We believe the best way to reach this end is to eliminate discretionary pricing in the subprime loan market, prompting lenders to adopt transparent, market-driven prices for mortgages representing similar risks.

Eliminating discretionary pricing in the subprime loan market would not necessarily mean eliminating yield-spread premiums. We believe homeowners should retain the right to pay for home loans through a variety of mechanisms, including yield-spread premiums when they truly benefit borrowers.[66] A number of sound options exist for achieving more rational pricing in the subprime market while still permitting broker compensation through YSPs where appropriate:

• Include YSPs in laws designed to protect homeowners from abusive lending practices. The Federal Reserve has the discretion to include YSPs in the calculation whether or not a loan is high-cost under the Home Ownership and Equity Protection Act (HOEPA),[67] and therefore eligible for special protections. Given the prevalence of YSPs in documented cases of predatory lending,[68] it makes no sense to ignore these fees in a law specifically designed to protect borrowers from predatory lending. This is a glaring loophole that affects all subprime loans originated by mortgage brokers, well over half the market.

• **Prohibit the combination of YSPs and prepayment penalties in the same subprime home loan.** Prepayment penalties and YSPs work together in ways that are contrary to borrowers' interests: prepayment penalties allow lenders to lock in an above-market yield, making them more willing to pay inflated YSPs to brokers for over-priced loans. We believe that's why our previous research revealed the counterintuitive result that borrowers with subprime loans that include prepayment penalties fail to receive lower interest rates than similarly-situated borrowers without prepayment penalties.[69] With prepayment penalties attached to overpriced loans, lenders benefit either way—they get paid either through payment of penalties at early payoff or through the higher-than-necessary interest paid out over time. Without the prepayment penalty, borrowers who realize they paid too much for their mortgage could quickly refinance into a lower-cost loan, and, as the lender understands, has every incentive to do so.

The combination of YSPs and prepayment penalties also creates opportunities for deceptive marketing. Prepayment penalties are commonly justified as an option by which borrowers may lower the interest rate, while YSPs are commonly justified as an option offered to exchange a higher interest rate for reduced closing costs. Given the link between higher YSPs and prepayment penalties, the YSP may in fact counter the benefits borrowers supposedly receive from prepayment penalties. The net result, indeed, may be that a borrower pays twice for little or no benefit.[70] Even if either a YSP or a prepayment penalty had a benefit to the borrower, the combination of the two in a subprime loan creates a serious impediment to informed borrower choice, and may be an indicator of potential abuse.[71]

• **Improve transparency of YSPs by requiring checks for YSPs to be written jointly to borrowers and brokers.** Currently, borrowers see YSPs as a cryptic entry on a closing form—if they see the charge at all. A joint-payee provision would mean that brokers could not cash a check without a borrower's endorsement, helping to ensure the borrower has full knowledge of the broker's compensation.

In general, reining in discretionary pricing in the subprime market would simplify an incredibly complicated mortgage process, remove an opportunity to discriminate against unsuspecting borrowers, and promote competition.

2. Follow the lead of the securities industry and hold lenders and brokers responsible for providing loans that are suitable for a given borrower.

Investment professionals have long had an affirmative duty to ensure that the products they recommend are suitable for their customers. Buying a home is the biggest investment that most families ever make, and, since the home's equity is the major source of wealth for most families, refinancing is an investment decision of more relevance to most families than stock purchases. Arguably today's mortgage transactions are at least as complicated as financial decisions made with investment professionals, yet families do not have a similar assurance that their lender or broker will deal fairly with them by offering them loans that are suitable given their needs and circumstances. A securities broker who steers a borrower into an inappropriate investment risks punishment; a mortgage broker who does the same may reap higher compensation with no negative consequences. To protect homebuyers and homeowners, lenders and brokers should be required to recommend loans that are suitable and reasonably advantageous for borrowers.[72]

Mortgage brokers, in particular, should have a fiduciary duty to borrowers to use best efforts to obtain the best available loan for the borrower. Brokers now originate nearly 60 percent of subprime mortgages.[73] Borrowers expect their brokers to represent their best interests, and brokers should be held to that standard. The stakes are too high to allow misplaced incentives to harm families' chances of paying a fair price for their home and building their net worth.

3. Discourage pricing discrimination by requiring subprime lenders to disclose more detailed pricing and underwriting information in their HMDA data.

The collection of APR information, as described in this report, is a positive first step in assessing pricing information, but it is of only limited value without a full disclosure of points and fees on subprime mortgages, including up-front fees, yield-spread premiums, and prepayment penalties. Not all up-front fees are captured in the APR. Further, in most cases, the APR understates the true costs of even those fees it captures because it amortizes them over the term of the loan, typically fifteen or thirty years. In fact, the vast majority of subprime home loans are paid off within the first two-to-five years. As a result, although two loans might have the same APR, a loan with high up-front fees typically costs borrowers much more. Information on points and fees would allow for a more accurate analysis of what families pay for their home loans.

In addition, as this research shows, HMDA data currently lacks information that would be helpful in evaluating how lenders serve their markets. HMDA should be modified to include the disclosure of factors such as loan-to-value ratios and credit scores of borrowers. In addition, HMDA should include the origination channel for each loan, so that researchers could better assess pricing differences or similarities among broker, correspondent and retail originations. Working in good faith, interested parties can produce a workable mechanism for providing critical information without unduly compromising privacy.[74]

4. Ensure regulators have adequate resources and authority, and are held accountable, for fully enforcing fair lending laws.

Fair lending violations are serious concerns. One of the main goals of HMDA is to help identify potential discriminatory lending patterns and to enforce anti-discrimination laws. Last year, based on the raw disparities evident in the 2004 HMDA data, the Fed referred some 200 lenders to federal and state regulators for further investigation. These 200 lenders accounted for 48 percent of owner-occupied loans reported under HMDA in 2004.[75] To date, no information about the outcome of those referrals has been made public. In the meantime, lenders already have submitted 2005 HMDA data to their federal regulators and early reports suggest that disparities have increased since 2004.[76]

It is important that regulators review and act on the information available to them in a timely and transparent fashion. Whether or not the regulators find that lenders have violated applicable laws, borrowers and the larger public need to know that the investigation process is fair and effective. To this end, we recommend that each regulator report annually on the number of fair lending examinations performed and for each examination provide publicly-available information, including: (1) the indicators of potential discriminatory activity identified (if any); (2) the protected class or classes (e.g., gender, race) believed to be potentially disadvantaged by such activity; and (3) the outcome of each review (i.e., any actions taken).

In addition, turf battles should not impede efforts to protect borrowers. In the wake of the release of the 2004 HMDA data, at least one federal regulator has put significant energy into a court action to

prevent a state attorney general from having access to information necessary to evaluate potentially discriminatory practices by lending institutions.[77] We wish it were clear that the same energy has been put into getting to the root of racial and ethnic disparities in home lending. It will take concerted efforts from all interested parties to ensure that similarly-situated families receive fairly-priced loans.

5. Create incentives and support a policy framework that leads the market to better serve communities of color.

Some of the key goals of HMDA include determining whether financial institutions are serving the housing needs of their communities and helping public officials to make public investments in a way that attracts private investment in areas that need it. Over time, it has become clear that not all credit is good credit. As discussed above, one reason African-American and Hispanic families are more likely to receive higher-rate loans may be that they tend to receive loans from lenders that generally charge more. Policymakers should review whether lower-cost lenders need additional incentives to help meet the credit needs of communities of color. Conversely, regulatory enforcers of fair lending laws should actively evaluate whether the higher-cost lenders "reverse red-line" by targeting communities of color for high-priced products unrelated to individual borrower risk.

When unscrupulous lending practices go unchecked, borrowers are not the only ones who suffer harm; lower-cost lenders and honest brokers also are placed at a disadvantage. They cannot compete with lenders or brokers who make loans on unfair or deceptive terms or who push-market loans that are not in a borrower's best interest. Laws and regulations that prohibit predatory, irresponsible subprime lending have proven effective in reducing the number of abusive loans while maintaining a vibrant market for subprime home loans.

A recent study by the Center for Responsible Lending showed that lenders have responded to strong state laws not by reducing the availability of subprime loans, but rather by making subprime home loans that do not contain the terms targeted by the laws.[78] Furthermore, the interest rates on subprime home loans were about the same or even lower than the rates in states that did not target those abusive loan terms.[79] Policymakers should endorse legislation that builds on the proven methods for protecting families from abusive lending while retaining access to subprime credit. Recognizing that new abuses continue to emerge, such laws should ensure that all those responsible for representing and protecting families have authority to act to address new problems.

APPENDIX 1: Credit Research Center Study

The Federal Reserve's report on 2004 HMDA data included research conducted by the Credit Research Center (CRC). In their analysis of loan data, the CRC found almost no disparities in the proportions of borrowers receiving higher-rate loans by race or ethnicity, after making adjustments for risk factors such as LTV and FICO scores. These findings have been erroneously cited to support the proposition that risk factors fully explain pricing disparities in the subprime market.[80] Even without considering the contradictory evidence presented in this paper, there are two reasons to be skeptical of this claim:

1. The data used in the CRC analysis does not appear to be representative of the subprime market.

CRC's analysis relied on 2004 HMDA data from eight unidentified subprime lenders, supplemented by proprietary information provided by those lenders. No information is provided on how these lenders were chosen nor whether they were representative of the subprime market as a whole. In fact, there is evidence that the composition of loans from these lenders is fundamentally different from that of the overall subprime market. For example, over 80 percent of both the purchase loans and refinance loans analyzed by CRC were higher-rate. However, CRL estimates that less than 50 percent of subprime lending falls into this category.[81] Since the data appears to be fairly non-representative of the subprime market, it is difficult to believe that the findings should be generalized to describe that market.

2. The methodology used in the CRC analysis is unclear and appears to be specified in a way that would limit disparities arising from brokered transactions.

The Fed's report does not contain important information on CRC's methodology, and it does not provide results for the control variables that were used in the analysis. This lack of clarity makes it difficult to understand the context for CRC's results and, consequently, what conclusions one can reasonably draw. Also of importance, CRC controlled for whether the loan was originated by a broker. This may be useful for isolating the impact of race and ethnicity on loan pricing on the one hand from the impact of the type of originator on the other. However, we believe that broker participation in loans itself is a potential source of disparities through discretionary up-selling by use of yield-spread premiums. The CRC's inclusion of the broker category as a control variable entirely ignores the effect that the broker plays in pricing loans to African-Americans or Latinos in a manner unrelated to risk, and therefore makes it impossible to assess whether these borrowers receive higher-cost mortgages than white borrowers unrelated to commonly-accepted risk factors.

APPENDIX 2: Matching HMDA Data with Another Database

We chose a conservative methodology to match HMDA reports and loans in the proprietary database in order to minimize the potential number of "bad matches." That is, we were willing to settle for a smaller number of loan matches in order to be confident that we were correctly matching specific loans. Below is a table outlining our matching process.

Process	Observations
Step 1: Select HMDA Loans: We first selected 2004 home purchase or refinance loan originations secured by owner-occupied, 1- to 4-unit or manufactured housing from selected HMDA lenders[82]	5,337,495 unique loan records
Step 2: Add Zip Code to HMDA: Next, we identified a dataset that provides a list of every census tract/zip code combination for the entire U.S. That is, for every census tract, there is a separate observation for every zip code that overlaps that tract. We merged our HMDA loans from step 1 with this census tract/zip code dataset	12,421,598 representing the 5,337,495 HMDA loans (there are multiple observations for loans with census tracts that overlap more than one zip code)
Step 3: Remove Non-Unique Loans: In step 3, we identified and removed HMDA loans that did not have unique combinations of the variables that were common to both datasets, namely lender name, state, zip code, loan purpose, property type, lien status, and loan amount.	9,292,170 (there are still multiple observations for loan with census tracts that overlap zip codes)
Step 4: Remove Overlapping Census Codes: To ensure that we had the right zip code for all of the loans in our analysis, in step 4 we deleted all loans that were not in census tracts that are completely encompassed within a single zip code.	1,968,148 unique HMDA loan records
Step 5: Select Loans: We then selected home purchase or refinance loans secured by owner-occupied 1-4 unit or manufactured housing originated in 2004 from the proprietary database.[83]	1,842,228 unique loan records from proprietary database
Step 6: Remove Non-Unique Loans: Next, we identified and removed loans from the proprietary database that did not have unique combinations of the following variables: i.e. state, zip code, loan purpose, property type, lien status, and loan amount.[84] Keep only loans from lenders in this dataset with more than 1,000 observations.	535,030 unique loan records from the proprietary database (includes loans in all census tracts, not just those fully encompassed in single zip codes)
Step 7. Merge HMDA and proprietary database sub-datasets: Finally, we merged the sub-datasets created in steps 4 and 6 by lender,[85] state, zip code, loan purpose, property type, lien status and loan amount. We kept only those loans that appeared in both datasets.	177,487 unique loan records in merged datasets

Using the 535,030 loans from the proprietary database that we tried to merge with HMDA as the denominator, we achieved a match rate of 33 percent. Since many of the loans in the proprietary database that we tried to match may have been removed from the HMDA loans eligible for matching due to "non-unique characteristics," this match rate seemed reasonable.

To check the validity of our matches, we selected a random sample of loans from the merged dataset. We searched for these loans in a third database called Leads-To-Loans.[86] We used data from the proprietary database to set the parameters in the following Leads-To-Loans search fields: origination date, origination amount, loan type, loan purpose, zip code and lender. Small ranges were used in the origination amount and date parameters, to account for slight variations in rounding or date entry. Loan information such as census tract and gender of borrower/co-borrower were then compared to comparable HMDA fields. Due to the limitations in Leads-To-Loans coverage, many of the loans that we randomly generated could not be found in Leads-To-Loans but, of the first 100 that were found, 93 were confirmed as matches.

APPENDIX 3: Comparison of Proprietary Database and Merged Dataset Mean Values by Loan Product

Table A.1 All Owner-Occupied Purchase Loans

Variable	All 2004 Loans in Proprietary Database (n = 725,262)	Merged Dataset Mean (n = 75,764)
FICO	663.7	652.6
LTV	86.3	87.0
TERM	340.6	341.0
ORIGINATION AMOUNT	181,252	191,792
INITIAL RATE	7.2	7.5
LOW/NO DOC STATUS (%)	46.4	44.0
PREPAYMENT PENALTY (%)	61.8	65.6
CENTRAL CITY (%)	33.3	33.4
OUTSIDE CENTRAL CITY (%)	58.4	58.2
RURAL (%)	8.3	8.4

Table A.2. All Owner-Occupied Refinance Loans

Variable	All 2004 Loans in Proprietary Database (n = 1,116,966)	Merged Dataset Mean (n = 101,723)
FICO	620.8	612.7
LTV	78.1	77.2
TERM	343.0	345.9
ORIGINATION AMOUNT	185,912	199,923
INITIAL RATE	7.1	7.3
LOW/NO DOC STATUS (%)	34.4	33.7
PREPAYMENT PENALTY (%)	66.3	68.0
CENTRAL CITY (%)	30.4	30.0
OUTSIDE CENTRAL CITY (%)	59.1	59.7
RURAL (%)	10.5	10.5

APPENDIX 4: The Expanded Models: Three-Stage, Least-Squares Model Specifications

Using our merged dataset, we employed logistical regressions to estimate the impact of race and ethnicity on the likelihood of a borrower receiving a "higher-rate" loan, that is, a loan that exceeds HMDA's APR spread reporting threshold.[87] Our "expanded" models (Models 2 and 3) correct for possible interdependence (or "endogeneity") between APR spread and several independent variables, namely LTV, origination amount, and prepayment penalties. As mentioned in the text of the report, the methodology and models are largely based on those used by Brent Ambrose, Michael LaCour-Little and Anthony Sanders, though modifications were made based on the availability of data and to reflect the different objectives of our analysis.[88]

To correct for possible the endogeneity of LTV and origination amount, which are continuous variables, with APR spread, we ran a Three-Stage, Least-Squares (3SLS) analysis:

1. First Stage: In the first stage, LTV and origination amount were each estimated using ordinary least squares regressions with the following independent variables, or "instruments": black, Latino, FICO, monthly_income, monthly_income2, refi, credit_spread, yield_curve, hpi_vol, rate_vol, hpi, subprime_rate,[89] prepay, full_doc, cdiv2-cdiv9, statelaw2-statelaw9, qtr2-qtr4, condo, n_ccity, rural, black_state, Latino_state, agency2-agency5. The estimations from these two regressions led to two new variables for each loan: LTV_instrumented and Orig_Amt_instrumented.

2. Second Stage: In the second stage, the actual LTV and origination amount variables were simultaneously estimated, using the following equations:

(A) ORIG_AMT = black Latino LTV_instrumented sub_rate monthly_income monthly_income2 HPI full_doc

(B) LTV = black Latino ORIG_AMT_instrumented FICO sub_rate monthly_income monthly_income2 HPI full_doc

3. Third Stage: In the third stage, the two equations in the second stage were automatically re-estimated, correcting for correlations between their error terms.

In the final logistic regression model we used the estimated LTV and origination amount variables from the third stage of the three-stage least squares regression instead of the actual LTVs and origination amounts. All other independent variables are identical to those in the base model. Using the estimated LTV and origination amount variables, rather than the actual values, avoids problems that would occur if these LTV and origination amount were, in fact, jointly-determined or "endogenous" with the APR of the loan.

Data Stratification for Binary Variable Prepayment Penalty

To correct for the potential endogeneity between APR spread and the existence of prepayment penalties (which is a binary variable), we ran the above expanded model specification separately for loans with and without prepayment penalties.[90] Specifically, Model 2 ran the model on loans without prepayment penalties and Model 3 ran the identical model on loans with prepayment penalties.

Variations on Methodology

To test the robustness of our model specification, we tried a few variations on our base model. Variations fell into three categories:

1. Less rigid restrictions on included loans: In one set of variations, we relaxed the criteria by which we included the matched data into our analysis dataset. Specifically, we allowed all matched loans to be included, regardless of whether the census tract was completely encompassed within a single zip code or overlapped multiple zip codes. This variation essentially doubled our sample size but slightly increased the chances that there would be "false" matches.

2. Changes in included independent variables: We also tried altering our model by modifying the independent variables that we included in the analysis. In one set, we removed the three state law dummy variables and replaced them with 49 state dummy variables. In another set, we added an interaction variable between FICO and LTV.

3. Altered functional form: Finally, we altered the functional form of two independent variables, using the logarithmic rather than the natural forms of LTV and origination amount.

Importantly, none of these variations altered the basic findings of our analysis. That is, estimates of the impact of race and ethnicity on the odds of receiving a higher-rate loan were largely consistent with our principal analysis.

APPENDIX 5: The Limitations of APR

While information on the APR spread is essential to understanding patterns of loan pricing, it is not sufficient. Without discrete information on the points, fees, and interest rates associated with loans, it is impossible to fully evaluate the actual cost of credit to the average borrower.

Consider two 30-year loans: Loan A carries a note rate of 10 percent and has no points or fees; Loan B carries a note rate of 9 percent but has financed fees equal to 10 percent of the loan principal. Both of these loans have APRs roughly equal to 10 percent (10.0 percent for loan A versus 10.1 percent for loan B), but the actual cost of the loans would likely be very different since a typical subprime loan might remain outstanding for only two years. In fact, if both loans are repaid at the 24th month, the Loan B, high-fee, borrower will have paid a total of $29,668 in interest and fees versus just $19,891 for the Loan A, no fee borrower. In other words, the Loan B borrower will pay 49 percent more than the Loan A borrower, despite having almost the same APR. This counterintuitive result is produced because APR assumes that points and fees are spread out and repaid over the full loan term.

The fact that APR hides the size of fees for most borrowers is not merely of academic concern. Since the rate spread between APR and Treasury securities is the only price information that lenders are required to report under HMDA, there is an incentive for lenders to shift some of their compensation from rates to fees, since they can obtain much greater compensation without changing the APR. This result is exactly the opposite of what responsible lending principles would dictate. Loan pricing is the most important issue in understanding the fairness of the mortgage market, and it is essential that the loan pricing information collected provide an accurate and complete picture of the cost of credit. Although abusive lending is often thought to be associated with high interest rates, the primary issue is high fees charged to borrowers.

Because of incentives to rely on fees for compensation, it is important that lenders be held accountable for charging fees that are fair and equitable. As noted in the policy recommendations of our report, we strongly urge the Federal Reserve to include mortgage fee information in the data collected under HMDA.

APPENDIX 6: Model Estimates and Descriptive Statistics

Table A.3. 30-Year Fixed-Rate Purchase Loans

Dependent Variable: 1 if APR_Spread Exceeds HMDA Reporting Threshold; 0 otherwise.									
Independent Variables	Model 1: Base Model			Model 2: Expanded Model, No Prepayment Penalties			Model 3: Expanded Model, With 3-Year Prepayment Penalties		
	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value
INTERCEPT	7.2747	2.3130	0.0017	7.7156	6.6300	0.2445	6.2408	2.7267	0.0221
BLACK	0.5378	0.1393	0.0001	0.4919	0.2578	0.0564	0.6078	0.1744	0.0005
HISPANIC	0.4675	0.1434	0.0011	1.0599	0.3279	0.0012	0.5361	0.1664	0.0013
MONTHLY INCOME	0.000013	0.000015	0.4029	0.000714	0.000088	<.0001	0.000049	0.000020	0.0143
LTV	0.0973	0.00548	<.0001	0.0905	0.0430	0.0355	0.1013	0.00846	<.0001
FICO	-0.0257	0.00114	<.0001	-0.0234	0.00226	<.0001	-0.0239	0.00143	<.0001
ORIG_AMT	-0.00001	1.092E-6	<.0001	-0.00007	6.874E-6	<.0001	-0.00002	1.871E-6	<.0001
CREDIT_SPREAD	1.2211	2.1943	0.5779	0.1043	4.2675	0.9805	2.2961	2.6639	0.3887
YIELD_CURVE	0.6371	0.6708	0.3423	1.1143	1.3226	0.3995	0.5051	0.7970	0.5263
HPI_VOL	0.0106	0.0103	0.3037	0.0988	0.0243	<.0001	0.0339	0.0142	0.0170
RATE_VOL	3.4599	3.0742	0.2604	8.5546	5.9516	0.1506	2.0903	3.7311	0.5753
CDIV2	0.0751	0.2866	0.7932	0.1996	0.6436	0.7565	-0.0295	0.3756	0.9374
CDIV3	0.1270	0.3274	0.6981	-0.7542	0.7577	0.3196	0.3642	0.4201	0.3860
CDIV4	0.2396	0.3564	0.5014	-0.0403	0.7453	0.9568	-0.2470	0.4938	0.6170
CDIV5	-0.1123	0.3219	0.7273	-1.5140	0.8702	0.0819	-0.0987	0.3777	0.7938
CDIV6	-0.3128	0.3923	0.4252	-1.6956	1.0246	0.0979	-0.2250	0.4862	0.6435
CDIV7	0.2936	0.4260	0.4907	-2.9589	1.0777	0.0060	0.5705	0.5572	0.3059
CDIV8	-0.1582	0.3791	0.6765	-1.1203	1.1593	0.3339	-0.2941	0.4496	0.5131
CDIV9	-0.5227	0.3302	0.1135	-0.9371	0.7636	0.2198	-0.6083	0.4102	0.1381
STATELAW2*	-0.1989	0.2090	0.3413	0.5323	0.3742	0.1549	-0.5116	0.3142	0.1035
STATELAW3*	-0.3619	0.1688	0.0320	-0.5712	0.2994	0.0564	-0.5702	0.2369	0.0161
STATELAW4*	-0.6954	0.3410	0.0414	-0.8977	0.8857	0.3108	-0.8500	0.4194	0.0427
CONDO	-0.0642	0.1888	0.7338	-0.3173	0.3639	0.3832	-0.0123	0.2375	0.9588
MULTI	0.4119	0.2282	0.0711	0.4756	0.3472	0.1708	0.2431	0.3059	0.4268
N_CCITY	-0.0956	0.1128	0.3970	-0.5587	0.2446	0.0223	0.0570	0.1326	0.6674
RURAL	0.3171	0.1535	0.0389	0.4609	0.2782	0.0976	0.2733	0.1916	0.1539
FULL_DOC	-1.2570	0.1218	<.0001	-1.4716	0.2660	<.0001	-1.4544	0.1503	<.0001
PREPAY	0.1595	0.1274	0.2106	NA	NA	NA	NA	NA	NA
BLACK_STATE	0.0268	0.0114	0.0185	0.0767	0.0256	0.0027	0.0187	0.0151	0.2137
HISPANIC_STATE	-0.0164	0.00762	0.0309	0.00565	0.0203	0.7811	-0.0198	0.00991	0.0453
AGENCY_CODE1**	-0.2057	0.1410	0.1447	-0.8857	0.2501	0.0004	0.6608	0.1904	0.0005
AGENCY_CODE2**	-0.3757	0.2818	0.1825	-0.2665	0.5122	0.6029	-0.1138	0.3391	0.7372
AGENCY_CODE3**	0.3726	0.2296	0.1047	0.7211	0.4529	0.1114	0.4145	0.2703	0.1252
AGENCY_CODE4**	0.4420	0.4692	0.3462	0.2114	0.9763	0.8286	0.6225	0.5634	0.2692
Q2	-1.0418	0.2134	<.0001	-0.8919	0.4047	0.0275	-1.0755	0.2560	<.0001
Q3	-0.3995	0.3964	0.3136	-0.8245	0.7662	0.2819	-0.2711	0.4780	0.5706
Q4	-0.0828	0.6104	0.8921	-1.1322	1.1487	0.3243	0.1919	0.7493	0.7979
Summary Statistics									
Number of Lenders	34			31			29		
Number of Observations	3679			1444			2235		
System R-Squared (3SLS Only)	NA			0.4522			0.4654		
Nagelkerke R-Squared	0.6150			0.6821			0.5748		
Cox-Snell R-Squared	0.4480			0.4661			0.4273		
KS Statistic** (all)	66.68			76.90			62.47		
KS Statistic (Black=1)	60.15			58.71			62.63		
KS Statistic (Hispanic=1)	66.59			73.26			64.11		
KS Statistic (Black=0, Hispanic=0)	67.24			80.42			60.93		

Table A.4. Descriptive Statistics for Table A.3 Analyses

DESCRIPTIVE STATISTICS FOR LOANS INCLUDED: 30-Year Fixed-Rate Purchase Loans						
Independent Variables	Model 1: Base Model		Model 2: Expanded Model, No Prepayment Penalties		Model 3: Expanded Model, With 3-Year Prepayment Penalties	
	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
HMDA_THRESHOLD	0.3571623	0.4792283	0.2617729	0.4397519	0.4187919	0.4934716
BLACK	0.1592824	0.3659890	0.1551247	0.3621489	0.1619687	0.3685045
HISPANIC	0.1777657	0.3823674	0.1239612	0.3296515	0.2125280	0.4091879
MONTHLY INCOME	5320.20	3989.15	5704.64	3689.36	5071.81	4153.32
LTV	83.1778391	11.7312862	82.1244598	10.7256256	83.8584116	12.2919362
FICO	659.5216091	68.7125013	687.5948753	71.3951747	641.3838926	60.3506785
ORIG_AMT	132112.62	73693.26	138620.21	76339.48	127908.16	71635.35
CREDIT_SPREAD	0.7607774	0.0470407	0.7580956	0.0482189	0.7625101	0.0461917
YIELD_CURVE	2.4402800	0.4311356	2.3756163	0.4511046	2.4820582	0.4124714
HPI_VOL	13.5382162	10.2578874	14.0250821	10.0373188	13.2236595	10.3880042
RATE_VOL	0.2311453	0.1253267	0.2477549	0.1299524	0.2204140	0.1210684
CDIV2	0.1195977	0.3245346	0.1738227	0.3790882	0.0845638	0.2782937
CDIV3	0.1361783	0.3430244	0.1675900	0.3736312	0.1158837	0.3201570
CDIV4	0.0554499	0.2288873	0.0983380	0.2978742	0.0277405	0.1642651
CDIV5	0.1891818	0.3917062	0.2590028	0.4382389	0.1440716	0.3512409
CDIV6	0.0470236	0.2117182	0.0325485	0.1775131	0.0563758	0.2306977
CDIV7	0.1889100	0.3914903	0.0858726	0.2802729	0.2554810	0.4362288
CDIV8	0.0603425	0.2381527	0.0526316	0.2233742	0.0653244	0.2471527
CDIV9	0.1427018	0.3498161	0.0796399	0.2708287	0.1834452	0.3871177
STATELAW2*	0.3549878	0.4785747	0.2409972	0.4278368	0.4286353	0.4949916
STATELAW3*	0.3547160	0.4784922	0.3871191	0.4872600	0.3337808	0.4716680
STATELAW4*	0.0350639	0.1839663	0.0311634	0.1738194	0.0375839	0.1902302
CONDO	0.1002990	0.3004391	0.1170360	0.3215746	0.0894855	0.2855071
MULTI	0.0524599	0.2229829	0.0630194	0.2430820	0.0456376	0.2087446
N_CCITY	0.4514814	0.4977080	0.4736842	0.4994800	0.4371365	0.4961434
RURAL	0.1527589	0.3598038	0.1731302	0.3784909	0.1395973	0.3466463
FULL_DOC	0.7088883	0.4543367	0.6952909	0.4604436	0.7176734	0.4502322
PREPAY	0.6075020	0.4883730	NA	NA	NA	NA
BLACK_STATE	11.9206578	7.8753342	13.4023546	8.5182927	10.9633557	7.2735417
HISPANIC_STATE	13.2127752	11.9050320	10.5168283	10.3609508	14.9545861	12.5006922
AGENCY_CODE1**	0.3234575	0.4678592	0.6038781	0.4892598	0.1422819	0.3494172
AGENCY_CODE2**	0.0277249	0.1642059	0.0221607	0.1472569	0.0313199	0.1742198
AGENCY_CODE3**	0.0456646	0.2087850	0.0332410	0.1793274	0.0536913	0.2254579
AGENCY_CODE4**	0.0097853	0.0984487	0.0062327	0.0787282	0.0120805	0.1092700
Q2	0.3574341	0.4793093	0.3247922	0.4684594	0.3785235	0.4851276
Q3	0.2962762	0.4566763	0.2915512	0.4546342	0.2993289	0.4580666
Q4	0.1788529	0.3832812	0.2257618	0.4182278	0.1485459	0.3557198

Table A.5. 2/28 Adjustable-Rate Purchase Loans

Dependent Variable: 1 if APR_Spread Exceeds HMDA Reporting Threshold; 0 otherwise.									
Independent Variables	Model 1: Base Model			Model 2: Expanded Model, No Prepayment Penalties			Model 3: Expanded Model, With 2-Year Prepayment Penalties		
	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value
INTERCEPT	10.0637	0.9600	<.0001	4.5718	2.2035	0.0380	9.4497	1.1802	<.0001
BLACK	0.2184	0.0545	<.0001	0.3344	0.1032	0.0012	0.3400	0.0666	<.0001
HISPANIC	0.0592	0.0529	0.2632	0.4173	0.1174	0.0004	0.5075	0.0637	<.0001
MONTHLY INCOME	0.000010	6.701E-6	0.1322	0.000253	0.000029	<.0001	0.000341	0.000019	<.0001
LTV	0.0954	0.00264	<.0001	0.1713	0.0186	<.0001	0.1250	0.00704	<.0001
FICO	-0.0198	0.000450	<.0001	-0.0173	0.00101	<.0001	-0.0197	0.000596	<.0001
ORIG_AMT	-0.00001	3.868E-7	<.0001	-0.00003	2.385E-6	<.0001	-0.00004	1.278E-6	<.0001
CREDIT_SPREAD	-4.6146	0.8896	<.0001	-3.4968	1.6435	0.0334	-5.1180	1.0552	<.0001
YIELD_CURVE	-0.4503	0.2741	0.1004	-0.6806	0.5271	0.1966	-0.3402	0.3199	0.2876
HPI_VOL	0.0125	0.00407	0.0022	0.0581	0.01000	<.0001	0.0570	0.00524	<.0001
RATE_VOL	6.9312	1.2519	<.0001	5.7033	2.3425	0.0149	7.4766	1.4789	<.0001
CDIV2	0.1567	0.0984	0.1111	-0.2896	0.2311	0.2102	-0.1611	0.1505	0.2845
CDIV3	0.3828	0.1140	0.0008	-0.3992	0.3165	0.2072	-0.0549	0.1374	0.6893
CDIV4	0.6123	0.1239	<.0001	-0.0276	0.3064	0.9282	-0.5489	0.1560	0.0004
CDIV5	0.0965	0.1165	0.4074	-0.0727	0.3750	0.8462	-0.6686	0.1315	<.0001
CDIV6	0.1045	0.1530	0.4946	-0.7111	0.4851	0.1427	-0.7180	0.1754	<.0001
CDIV7	0.8475	0.1863	<.0001	-0.2746	0.5652	0.6271	-0.4771	0.2280	0.0364
CDIV8	0.1630	0.1402	0.2447	-0.6998	0.4803	0.1451	-0.8667	0.1667	<.0001
CDIV9	-0.0857	0.1235	0.4879	-0.1901	0.3069	0.5356	-1.1120	0.1522	<.0001
STATELAW2*	-0.1685	0.0849	0.0471	-0.7476	0.1712	<.0001	0.0826	0.1125	0.4631
STATELAW3*	-0.0411	0.0593	0.4884	-0.1405	0.1135	0.2157	-0.4484	0.0816	<.0001
STATELAW4*	-0.4508	0.1269	0.0004	-0.4470	0.2462	0.0694	-0.6028	0.1923	0.0017
CONDO	-0.0760	0.0659	0.2487	-0.1318	0.1235	0.2856	-0.0216	0.0778	0.7809
MULTI	0.4716	0.0830	<.0001	0.3591	0.1250	0.0041	0.5669	0.1115	<.0001
N_CCITY	-0.1470	0.0448	0.0010	-0.0853	0.0921	0.3541	-0.1407	0.0514	0.0062
RURAL	0.1509	0.0694	0.0296	0.1060	0.1335	0.4273	0.1642	0.0809	0.0424
FULL_DOC	-1.3165	0.0476	<.0001	-1.8540	0.1053	<.0001	-1.5877	0.0608	<.0001
PREPAY	-0.2295	0.0539	<.0001	NA	NA	NA	NA	NA	NA
BLACK_STATE	0.00567	0.00461	0.2190	-0.0146	0.0124	0.2376	0.00967	0.00600	0.1074
HISPANIC_STATE	-0.0144	0.00348	<.0001	0.00595	0.00936	0.5251	-0.0205	0.00429	<.0001
AGENCY_CODE1**	0.1873	0.0774	0.0156	0.2146	0.1709	0.2093	0.3614	0.0877	<.0001
AGENCY_CODE2**	1.4713	0.1707	<.0001	1.9051	0.2958	<.0001	1.3998	0.2063	<.0001
AGENCY_CODE3**	3.9680	0.1027	<.0001	4.1063	0.3032	<.0001	3.9572	0.1114	<.0001
AGENCY_CODE4**	-3.5262	0.2976	<.0001	-3.4359	0.7603	<.0001	-3.4687	0.3232	<.0001
Q2	-1.0721	0.0857	<.0001	-0.9739	0.1601	<.0001	-1.0746	0.1010	<.0001
Q3	-1.2467	0.1588	<.0001	-1.2600	0.2933	<.0001	-1.1533	0.1885	<.0001
Q4	-1.4299	0.2356	<.0001	-1.5617	0.4299	0.0003	-1.5209	0.2804	<.0001
Summary Statistics									
Number of Lenders	35			33			32		
Number of Observations	17978			4657			13321		
System R-Squared (3SLS Only)	NA			0.3273			0.4162		
Nagelkerke R-Squared	0.5247			0.4484			0.5393		
Cox-Snell R-Squared	0.3932			0.3358			0.4042		
KS Statistic (all)	58.52			54.30			59.63		
KS Statistic (Black=1)	59.88			57.64			60.84		
KS Statistic (Hispanic=1)	57.00			51.88			58.68		
KS Statistic (Black=0, Hispanic=0)	57.97			53.51			59.15		

Table A.6. Descriptive Statistics for Table A.5 Analyses

DESCRIPTIVE STATISTICS FOR LOANS INCLUDED: 2/28 Adjustable						
Independent Variables	Model 1: Base Model		Model 2: Expanded Model, No Prepayment Penalties		Model 3: Expanded Model, With 2-Year Prepayment Penalties	
	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
HMDA_THRESHOLD	0.5238625	0.4994441	0.5323169	0.4990081	0.5209068	0.4995815
BLACK	0.2020247	0.4015217	0.2447928	0.4300104	0.1870730	0.3899848
HISPANIC	0.2364557	0.4249170	0.2061413	0.4045766	0.2470535	0.4313143
MONTHLY INCOME	5343.82	3514.17	5810.80	4215.86	5180.56	3217.36
LTV	85.1187657	9.0612566	84.8905025	9.2225980	85.1985662	9.0031550
FICO	626.4640116	56.2751246	630.4109942	58.6704740	625.0841528	55.3491950
ORIG_AMT	148115.69	75359.67	159016.83	80526.92	144304.67	73088.10
CREDIT_SPREAD	0.7636333	0.0474368	0.7610436	0.0483879	0.7645387	0.0470679
YIELD_CURVE	2.3808088	0.4306069	2.3530170	0.4432163	2.3905247	0.4256998
HPI_VOL	16.2474764	11.3368526	18.0448063	10.8214964	15.6191328	11.4455784
RATE_VOL	0.2509125	0.1248711	0.2583326	0.1271226	0.2483185	0.1239745
CDIV2	0.1185338	0.3232481	0.3231694	0.4677370	0.0469935	0.2116328
CDIV3	0.1698743	0.3755328	0.2370625	0.4253266	0.1463854	0.3535054
CDIV4	0.0574035	0.2326184	0.0609835	0.2393257	0.0561519	0.2302235
CDIV5	0.1742686	0.3793508	0.2001288	0.4001396	0.1652278	0.3714000
CDIV6	0.0366559	0.1879208	0.0141722	0.1182132	0.0445162	0.2062467
CDIV7	0.1087440	0.3113264	0.0092334	0.0956563	0.1435328	0.3506285
CDIV8	0.0793192	0.2702438	0.0380073	0.1912344	0.0937617	0.2915079
CDIV9	0.1464568	0.3535734	0.0429461	0.2027574	0.1826439	0.3863888
STATELAW2*	0.3020358	0.4591535	0.1477346	0.3548748	0.3559793	0.4788269
STATELAW3*	0.3487040	0.4765733	0.4584496	0.4983241	0.3103371	0.4626489
STATELAW4*	0.0310936	0.1735754	0.0543268	0.2266858	0.0229712	0.1498174
CONDO	0.1104684	0.3134814	0.1047885	0.3063136	0.1124540	0.3159361
MULTI	0.0733674	0.2607459	0.1183165	0.3230172	0.0576533	0.2330955
N_CCITY	0.5213038	0.4995598	0.5780545	0.4939229	0.5014639	0.5000166
RURAL	0.1139726	0.3177869	0.1185312	0.3232708	0.1123790	0.3158440
FULL_DOC	0.5921682	0.4914453	0.5267339	0.4993384	0.6150439	0.4866032
PREPAY	0.7409612	0.4381191	NA	NA	NA	NA
BLACK_STATE	11.2625987	7.3445345	13.9992270	8.1215011	10.3058779	6.7979462
HISPANIC_STATE	12.9946379	10.9334054	10.7371699	8.1750870	13.7838451	11.6433459
AGENCY_CODE1**	0.0730893	0.2602903	0.0459523	0.2094042	0.0825764	0.2752512
AGENCY_CODE2**	0.0136278	0.1159431	0.0193257	0.1376820	0.0116358	0.1072438
AGENCY_CODE3**	0.1232618	0.3287466	0.0839596	0.2773570	0.1370017	0.3438621
AGENCY_CODE4**	0.0086773	0.0927494	0.0073008	0.0851416	0.0091585	0.0952642
Q2	0.2995884	0.4580904	0.2883831	0.4530589	0.3035057	0.4597889
Q3	0.3478696	0.4763076	0.3459309	0.4757219	0.3485474	0.4765282
Q4	0.2077539	0.4057110	0.2329826	0.4227766	0.1989340	0.3992133

Table A.7. 30-Year Fixed-Rate Refinance Loans

Dependent Variable: 1 if APR_Spread Exceeds HMDA Reporting Threshold; 0 otherwise.									
Independent Variables	Model 1: Base Model			Model 2: Expanded Model, No Prepayment Penalties			Model 3: Expanded Model, With 3-Year Prepayment Penalties		
	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value
INTERCEPT	15.8297	1.4007	<.0001	11.6955	2.5423	<.0001	16.0805	1.7312	<.0001
BLACK	0.3631	0.0841	<.0001	0.2117	0.1364	0.1207	0.4801	0.1091	<.0001
HISPANIC	0.1008	0.0991	0.3095	0.2537	0.1617	0.1167	0.0688	0.1286	0.5929
MONTHLY INCOME	0.000015	0.000011	0.1433	-1.91E-6	0.000021	0.9265	-2.32E-6	0.000011	0.8345
LTV	0.0414	0.00243	<.0001	0.0667	0.00537	<.0001	0.0547	0.00346	<.0001
FICO	-0.0252	0.000736	<.0001	-0.0250	0.00118	<.0001	-0.0265	0.000953	<.0001
ORIG_AMT	-0.00002	7.162E-7	<.0001	-0.00001	1.599E-6	<.0001	-0.00001	8.293E-7	<.0001
CREDIT_SPREAD	1.7978	1.3217	0.1738	0.0965	2.2935	0.9664	2.8682	1.6516	0.0824
YIELD_CURVE	-0.9365	0.3945	0.0176	0.0820	0.7003	0.9068	-1.4983	0.4870	0.0021
HPI_VOL	-0.00865	0.00665	0.1934	-0.00866	0.0144	0.5480	-0.00168	0.00907	0.8531
RATE_VOL	-1.1198	1.8260	0.5397	2.5437	3.1980	0.4264	-2.9463	2.2781	0.1959
CDIV2	0.4600	0.1742	0.0083	0.7075	0.4341	0.1032	0.1009	0.2254	0.6545
CDIV3	0.2478	0.1990	0.2130	-0.4372	0.5200	0.4005	0.5203	0.2494	0.0370
CDIV4	0.2166	0.2099	0.3021	0.7391	0.4952	0.1355	-0.1361	0.2843	0.6320
CDIV5	0.5643	0.1961	0.0040	0.3421	0.6355	0.5904	0.5536	0.2197	0.0117
CDIV6	0.3284	0.2463	0.1824	0.0935	0.7645	0.9026	0.3345	0.2948	0.2565
CDIV7	0.4656	0.2785	0.0946	-0.0738	0.7595	0.9226	0.3011	0.3513	0.3914
CDIV8	0.0417	0.2382	0.8609	-0.0877	0.8053	0.9133	0.0119	0.2890	0.9671
CDIV9	-0.1919	0.2097	0.3601	-0.1810	0.5917	0.7596	-0.2426	0.2507	0.3332
STATELAW2*	-0.2214	0.1322	0.0939	-0.1506	0.2686	0.5751	0.0631	0.1815	0.7279
STATELAW3*	-0.2917	0.1060	0.0059	-0.3247	0.2060	0.1150	-0.1812	0.1391	0.1927
STATELAW4*	-0.0467	0.2154	0.8284	0.2262	0.5089	0.6567	0.1131	0.2588	0.6620
CONDO	0.0690	0.1345	0.6079	0.2613	0.2348	0.2658	0.0367	0.1682	0.8274
MULTI	0.2138	0.1649	0.1947	0.1121	0.2613	0.6678	0.3787	0.2159	0.0795
N_CITY	-0.0760	0.0713	0.2868	-0.0291	0.1261	0.8178	-0.1521	0.0885	0.0858
RURAL	0.2939	0.0984	0.0028	0.5225	0.1679	0.0019	0.1335	0.1252	0.2863
FULL_DOC	-1.0787	0.0771	<.0001	-1.2074	0.1353	<.0001	-1.1375	0.0967	<.0001
PREPAY	-0.3831	0.0775	<.0001	NA	NA	NA	NA	NA	NA
BLACK_STATE	-0.00150	0.00693	0.8281	0.0224	0.0199	0.2600	-0.00345	0.00844	0.6826
HISPANIC_STATE	-0.00438	0.00525	0.4035	0.0123	0.0145	0.3954	-0.0171	0.00706	0.0156
AGENCY_CODE1**	0.0117	0.1200	0.9226	-0.4147	0.2034	0.0414	0.2008	0.1536	0.1911
AGENCY_CODE2**	-0.0886	0.1293	0.4932	-0.1293	0.2030	0.5242	-0.1307	0.1708	0.4443
AGENCY_CODE3**	0.2738	0.1460	0.0608	0.00968	0.2701	0.9714	0.3091	0.1762	0.0794
AGENCY_CODE4**	0.5487	0.2944	0.0623	0.8479	0.4803	0.0775	0.3273	0.3880	0.3989
Q2	-0.7977	0.1233	<.0001	-0.9243	0.2193	<.0001	-0.7621	0.1524	<.0001
Q3	-0.2754	0.2427	0.2565	-0.5904	0.4226	0.1624	-0.1372	0.3045	0.6522
Q4	-0.2275	0.3787	0.5480	-0.3493	0.6351	0.5823	-0.2133	0.4840	0.6594
Summary Statistics									
Number of Lenders	37			35			28		
Number of Observations	8799			2881			5918		
System R-Squared (3SLS Only)	NA			0.4703			0.5405		
Nagelkerke R-Squared	0.5426			0.5480			0.5357		
Cox-Snell R-Squared	0.3857			0.4057			0.3679		
KS Statistic (all)	61.97			60.55			63.19		
KS Statistic (Black=1)	58.58			55.23			64.82		
KS Statistic (Hispanic=1)	65.99			62.10			66.94		
KS Statistic (Black=0, Hispanic=0)	60.86			61.74			60.96		

Table A.8: Descriptive Statistics for Table A.7 Analyses

DESCRIPTIVE STATISTICS FOR LOANS INCLUDED: 30-Year Fixed-Rate Refinance Loans						
Independent Variables	Model 1: Base Model		Model 2: Expanded Model, No Prepayment Penalties		Model 3: Expanded Model, With 3-Year Prepayment Penalties	
Mean	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
HMDA_THRESHOLD	0.3116263	0.4631843	0.4026380	0.4905142	0.2673200	0.4425982
BLACK	0.1635413	0.3698798	0.1975009	0.3981825	0.1470091	0.3541449
HISPANIC	0.1663825	0.3724448	0.1516834	0.3587761	0.1735384	0.3787440
MONTHLY INCOME	5027.29	3753.60	5224.43	4042.48	4931.33	3601.05
LTV	74.3785794	17.0294092	74.7270878	15.4111633	74.2089186	17.7627082
FICO	622.1256961	61.5483839	617.7913919	64.7890156	624.2357215	59.7994058
ORIG_AMT	144755.23	75417.42	134762.92	74586.43	149619.68	75346.79
CREDIT_SPREAD	0.7598307	0.0470648	0.7587851	0.0469742	0.7603396	0.0471045
YIELD_CURVE	2.4846414	0.4291438	2.4466366	0.4417362	2.5031430	0.4216777
HPI_VOL	16.3065975	11.3412298	12.5721322	10.4541944	18.1246094	11.3119061
RATE_VOL	0.2179913	0.1247948	0.2280747	0.1287663	0.2130825	0.1225259
CDIV2	0.1170588	0.3215086	0.2054842	0.4041251	0.0740115	0.2618117
CDIV3	0.1138766	0.3176794	0.1277334	0.3338507	0.1071308	0.3093056
CDIV4	0.0429594	0.2027772	0.0527595	0.2235917	0.0381886	0.1916675
CDIV5	0.1717241	0.3771619	0.1818813	0.3858136	0.1667793	0.3728102
CDIV6	0.0371633	0.1891726	0.0156196	0.1240199	0.0476512	0.2130452
CDIV7	0.1525173	0.3595421	0.2877473	0.4527913	0.0866847	0.2813962
CDIV8	0.0640982	0.2449417	0.0430406	0.2029838	0.0743494	0.2623609
CDIV9	0.2007046	0.4005503	0.0458174	0.2091252	0.2761068	0.4471081
STATELAW2*	0.3811797	0.4857042	0.4015967	0.4903063	0.3712403	0.4831774
STATELAW3*	0.3420843	0.4744346	0.3703575	0.4829843	0.3283204	0.4696418
STATELAW4*	0.0281850	0.1655105	0.0114544	0.1064288	0.0363298	0.1871254
CONDO	0.0634163	0.2437241	0.0541479	0.2263485	0.0679284	0.2516442
MULTI	0.0505739	0.2191385	0.0558834	0.2297362	0.0479892	0.2137614
N_CCITY	0.5247187	0.4994170	0.4887192	0.4999595	0.5422440	0.4982543
RURAL	0.1297875	0.3360886	0.1384936	0.3454773	0.1255492	0.3313686
FULL_DOC	0.7371292	0.4402179	0.7125998	0.4526284	0.7490706	0.4335846
PREPAY	0.6725764	0.4692999	NA	NA	NA	NA
BLACK_STATE	11.2374702	7.7395043	13.5127039	7.4202481	10.1298412	7.6497172
HISPANIC_STATE	14.7443232	12.2263634	16.7137452	12.6442809	13.7855694	11.9013573
AGENCY_CODE1**	0.0814865	0.2735964	0.1263450	0.3322955	0.0596485	0.2368545
AGENCY_CODE2**	0.0636436	0.2441308	0.0694203	0.2542117	0.0608314	0.2390409
AGENCY_CODE3**	0.0479600	0.2136938	0.0395696	0.1949796	0.0520446	0.2221358
AGENCY_CODE4**	0.0100011	0.0995100	0.0124957	0.1111027	0.0087868	0.0933328
Q2	0.3809524	0.4856485	0.3668865	0.4820388	0.3877999	0.4872897
Q3	0.2634390	0.4405235	0.2776814	0.4479331	0.2565056	0.4367410
Q4	0.1572906	0.3640952	0.1794516	0.3837966	0.1465022	0.3536388

Table A.9. 2/28 Adjustable-Rate Refinance Loans

Dependent Variable: 1 if APR_Spread Exceeds HMDA Reporting Threshold; 0 otherwise.									
Independent Variables	Model 1: Base Model			Model 2: Expanded Model, No Prepayment Penalties			Model 3: Expanded Model, With 2-Year Prepayment Penalties		
	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value
INTERCEPT	16.2362	0.8645	<.0001	12.7901	1.4367	<.0001	16.0448	1.0979	<.0001
BLACK	0.1486	0.0532	0.0052	0.0386	0.0845	0.6481	0.1599	0.0689	0.0202
HISPANIC	-0.0679	0.0569	0.2328	-0.1694	0.0958	0.0771	-0.0613	0.0711	0.3891
MONTHLY INCOME	0.000018	5.524E-6	0.0015	1.769E-6	3.22E-6	0.5827	-0.00001	6.581E-6	0.0579
LTV	0.0297	0.00152	<.0001	0.0600	0.00373	<.0001	0.0641	0.00319	<.0001
FICO	-0.0210	0.000446	<.0001	-0.0225	0.000771	<.0001	-0.0249	0.000619	<.0001
ORIG_AMT	-9.27E-6	3.472E-7	<.0001	-5.89E-6	5.056E-7	<.0001	-4.77E-6	2.799E-7	<.0001
CREDIT_SPREAD	-5.3585	0.8370	<.0001	-4.8445	1.3923	0.0005	-6.0564	1.0591	<.0001
YIELD_CURVE	-0.4180	0.2455	0.0887	0.0104	0.4135	0.9800	-0.6611	0.3071	0.0314
HPI_VOL	0.00714	0.00399	0.0733	0.00904	0.00897	0.3136	0.0142	0.00513	0.0057
RATE_VOL	7.1831	1.1513	<.0001	8.2869	1.9114	<.0001	6.6298	1.4509	<.0001
CDIV2	0.3503	0.0908	0.0001	0.3687	0.2216	0.0961	0.4139	0.1377	0.0027
CDIV3	0.4561	0.1126	<.0001	0.2167	0.2940	0.4610	0.7458	0.1390	<.0001
CDIV4	0.3843	0.1158	0.0009	0.4965	0.2816	0.0779	0.4343	0.1501	0.0038
CDIV5	0.3924	0.1163	0.0007	0.6267	0.3485	0.0722	0.3383	0.1324	0.0106
CDIV6	0.5309	0.1566	0.0007	-0.0242	0.4663	0.9585	0.7907	0.1809	<.0001
CDIV7	0.8109	0.1841	<.0001	1.2648	0.4375	0.0038	0.7804	0.2288	0.0006
CDIV8	0.3328	0.1407	0.0180	0.6997	0.4382	0.1103	0.3919	0.1729	0.0234
CDIV9	0.3854	0.1233	0.0018	1.0825	0.3095	0.0005	0.2833	0.1557	0.0689
STATELAW2*	-0.0306	0.0792	0.6997	-0.1880	0.1674	0.2613	0.000409	0.1061	0.9969
STATELAW3*	-0.1378	0.0549	0.0121	-0.1398	0.0971	0.1498	-0.0689	0.0786	0.3808
STATELAW4*	-0.0598	0.1127	0.5957	-0.0372	0.2178	0.8645	0.2412	0.1903	0.2050
CONDO	-0.1800	0.0704	0.0105	-0.0442	0.1312	0.7361	-0.1988	0.0841	0.0181
MULTI	0.1116	0.0861	0.1950	0.2234	0.1225	0.0683	0.0703	0.1232	0.5684
N_CCITY	0.0159	0.0441	0.7194	-0.0136	0.0819	0.8681	0.0221	0.0531	0.6777
RURAL	0.0774	0.0660	0.2408	0.2139	0.1134	0.0593	0.0145	0.0822	0.8595
FULL_DOC	-0.7106	0.0427	<.0001	-0.6839	0.0727	<.0001	-0.7708	0.0537	<.0001
PREPAY	-0.3096	0.0486	<.0001	NA	NA	NA	NA	NA	NA
BLACK_STATE	0.00227	0.00416	0.5859	-0.00314	0.0115	0.7845	0.000933	0.00528	0.8599
HISPANIC_STATE	-0.0148	0.00358	<.0001	-0.0240	0.00892	0.0072	-0.0122	0.00476	0.0100
AGENCY_CODE1**	-0.4308	0.0951	<.0001	-0.5866	0.2003	0.0034	-0.4432	0.1097	<.0001
AGENCY_CODE2**	1.0246	0.1226	<.0001	0.9463	0.2015	<.0001	1.0933	0.1557	<.0001
AGENCY_CODE3**	3.1346	0.1028	<.0001	3.4348	0.2349	<.0001	3.0866	0.1169	<.0001
AGENCY_CODE4**	-1.5514	0.1403	<.0001	-1.4069	0.2626	<.0001	-1.6542	0.1667	<.0001
Q2	-1.1222	0.0778	<.0001	-1.1334	0.1308	<.0001	-1.1306	0.0978	<.0001
Q3	-1.2237	0.1507	<.0001	-1.3236	0.2479	<.0001	-1.1872	0.1912	<.0001
Q4	-1.3254	0.2291	<.0001	-1.3604	0.3858	0.0004	-1.3964	0.2875	<.0001
Summary Statistics									
Number of Lenders	32			32			30		
Number of Observations	18470			6520			11950		
System R-Squared (3SLS Only)	NA			0.4013			0.4115		
Nagelkerke R-Squared	0.4443			0.4199			0.4582		
Cox-Snell R-Squared	0.3304			0.3086			0.3421		
KS Statistic (all)	52.97			52.50			53.33		
KS Statistic (Black=1)	53.47			50.73			55.66		
KS Statistic (Hispanic=1)	55.70			60.69			53.27		
KS Statistic (Black=0, Hispanic=0)	52.22			51.21			52.63		

Table A.10. Descriptive Statistics for Table A.9 Analyses

DESCRIPTIVE STATISTICS FOR LOANS INCLUDED: 30-Year Fixed-Rate Refinance Loans						
Independent Variables	Model 1: Base Model		Model 2: Expanded Model, No Prepayment Penalties		Model 3: Expanded Model, With 2-Year Prepayment Penalties	
	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
HMDA_THRESHOLD	0.5799675	0.4935771	0.6199387	0.4854388	0.5581590	0.4966268
BLACK	0.1720087	0.3773982	0.1993865	0.3995698	0.1570711	0.3638830
HISPANIC	0.1558744	0.3627460	0.1460123	0.3531456	0.1612552	0.3677816
MONTHLY INCOME	5353.42	7393.47	5642.15	9599.00	5195.88	5843.90
LTV	77.5913806	14.2486355	76.6494156	13.9957800	78.1053230	14.3592691
FICO	581.9901462	52.1422822	579.9953988	52.4949334	583.0784937	51.9187601
ORIG_AMT	158127.28	76419.73	157820.78	79767.94	158294.50	74532.41
CREDIT_SPREAD	0.7644564	0.0475109	0.7638696	0.0484686	0.7647766	0.0469792
YIELD_CURVE	2.3898370	0.4290033	2.3766656	0.4343851	2.3970234	0.4258848
HPI_VOL	17.1887053	11.3851665	16.7198476	11.1623787	17.4445172	11.4973055
RATE_VOL	0.2478475	0.1249930	0.2516119	0.1257642	0.2457937	0.1245275
CDIV2	0.1635625	0.3698881	0.3483129	0.4764723	0.0627615	0.2425437
CDIV3	0.1707634	0.3763123	0.1815951	0.3855400	0.1648536	0.3710639
CDIV4	0.0634001	0.2436878	0.0562883	0.2304954	0.0672803	0.2505174
CDIV5	0.1658365	0.3719439	0.1621166	0.3685860	0.1678661	0.3737630
CDIV6	0.0304277	0.1717657	0.0105828	0.1023349	0.0412552	0.1988883
CDIV7	0.0831619	0.2761342	0.1378834	0.3448040	0.0533054	0.2246513
CDIV8	0.0743368	0.2623252	0.0286810	0.1669211	0.0992469	0.2990057
CDIV9	0.1436925	0.3507871	0.0213190	0.1444566	0.2104603	0.4076526
STATELAW2*	0.2772063	0.4476313	0.2266871	0.4187206	0.3047699	0.4603292
STATELAW3*	0.3453167	0.4754843	0.4110429	0.4920607	0.3094561	0.4622888
STATELAW4*	0.0391987	0.1940727	0.0610429	0.2394274	0.0272803	0.1629059
CONDO	0.0795885	0.2706624	0.0633436	0.2435985	0.0884519	0.2839628
MULTI	0.0582025	0.2341323	0.0848160	0.2786290	0.0436820	0.2043952
N_CCITY	0.5621007	0.4961419	0.5857362	0.4926322	0.5492050	0.4975938
RURAL	0.1185707	0.3232914	0.1259202	0.3317849	0.1145607	0.3185043
FULL_DOC	0.6724418	0.4693354	0.6714724	0.4697138	0.6729707	0.4691477
PREPAY	0.6469951	0.4779171	NA	NA	NA	NA
BLACK_STATE	11.4531402	7.7867151	13.7248160	7.5573588	10.2136987	7.6292737
HISPANIC_STATE	12.3859394	10.6503757	13.2491411	10.0689991	11.9149707	10.9262702
AGENCY_CODE1**	0.0371413	0.1891131	0.0225460	0.1484624	0.0451046	0.2075422
AGENCY_CODE2**	0.0229561	0.1497677	0.0250000	0.1561369	0.0218410	0.1461703
AGENCY_CODE3**	0.0916622	0.2885563	0.0713190	0.2573767	0.1027615	0.3036598
AGENCY_CODE4**	0.0171088	0.1296805	0.0130368	0.1134408	0.0193305	0.1376897
Q2	0.2905793	0.4540420	0.2763804	0.4472415	0.2983264	0.4575426
Q3	0.3397401	0.4736337	0.3411043	0.4741167	0.3389958	0.4733882
Q4	0.2006497	0.4004973	0.2118098	0.4086221	0.1945607	0.3958787

*The state law variables rely on the categories created by Ambrose, LaCour-Little and Anthony Sanders in their paper "The Effect of Conforming Loan Status on Mortgage Yield Spreads: A Loan Level Analysis." These categories are based on the legal environment in states with regard to judicial foreclosure and deficiency judgement. The states are grouped as follows:

STATELAW2 = AK, AZ, CA, ID, OK, ME, MN, MT, NC, OR, SD, TX, WA
STATELAW3 = CT, DE, FL, IL, IN, KS, KY, NJ, OH, PA, SC, VT
STATELAW4 = LA, ND, WI
(reference category = AL, AR, DC, GA, HI, MO, IA, MA, MD, MI, MS, RI, NE, NH, NM, NV, NY, TN, UT, VA, WV, WY, CO)

*The agency codes reflect the regulatory agency to which the lender reports. The codes represent the following:
AGENCY_CODE1 = OCC
AGENCY_CODE2 = FRS
AGENCY_CODE3 = FDIC
AGENCY_CODE4 = OTS
(reference category = HUD)

APPENDIX 7: ODDS AND LIKELIHOODS

When logistical regressions are used to test the relationship between categorical independent variables and a binary dependent variable (in our case, the relationship between race, ethnicity and whether the APR spread exceeded HMDA's reporting threshold), the most straightforward measure of the "impact" of the independent variable on the dependent variable is the odds ratio. While not often used outside of this type of analysis, odds ratios are fairly easy to understand and are closely related to likelihood ratios.

Difference Between Odds and Likelihood

In analyses of social outcomes, likelihoods are often used to draw conclusions. The likelihood of a particular event happening is the same as the probability that that event will happen. For example, if 40 percent of all subprime borrowers received a high-APR loan in 2004, then the likelihood that a randomly chosen subprime borrower received such a loan is 40 percent. The odds of an event happening, however, is equal to the probability of the event happening divided by the probability that the event will not happen. Thus, the odds of that randomly-selected borrower receiving a high-APR loan is simply equal to the likelihood that he will receive a high-APR loan divided by the likelihood that he will not. To put it in basic mathematic terms:

Odds = P/(1-P), where P is the probability or likelihood of a particular event happening and (1-P) is, therefore, the probability of that event not happening.

In our example above, the odds of a randomly selected subprime borrower receiving a high-APR loan is equal to 0.4/(1-0.4), or 67 percent.

By extension, an odds ratio, therefore, is simply the ratio between the odds for different types of borrowers. If, hypothetically, the probability of an African-American borrower receiving a high-APR loan is 30 percent, the odds for that borrower is 0.3/0.7 or 0.43. If the probability for a similarly-situated white borrower receiving a high-APR loan is 20 percent, the odds for that borrower is 0.2/0.8 or 0.25. The odds ratio between black and white borrowers, therefore, is 0.43/0.25 or 1.72. The interpretation of this odds ratio is as follows: The odds of an African-American borrower receiving a high-APR loan are 72 percent greater than those of a similarly-situated white borrower.

Odds ratios can be directly computed from logistic regressions. However, the underlying odds and, therefore, likelihoods cannot be directly calculated. This is why odds ratios, despite being less intuitive measures than likelihoods, are generally used when describing results from logistic regressions.

To convert the results into likelihoods, which are more intuitive, we conduct a simulation where we use our model coefficients to compute the average predicted probabilities of receiving a higher-rate loan for the African-American and Latino borrowers in our dataset and compare those to the average predicted probabilities for the same borrowers if they had been white. So, for our example, if for a specific loan product the average predicted probability of receiving a higher-rate APR was 30 percent for the African-American borrower in our dataset but would have been 20 percent if those same borrowers had been white, our "increased likelihood" would be (0.3-0.2)/0.2 or 50 percent.

NOTES

1 12 U.S.C. § 2801 *et seq.*

2 12 U.S.C. § 2901 *et. seq.*

3 15 U.S.C. § 1691 *et seq.*

4 12 U.S.C. § 1735f-7a.

5 *See, e.g.*, Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved With Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, Vol. 51, South Carolina Law Review, pp535–539, App. 1, pp576–587; Alan M. White, *Risk-Based Mortgage Pricing: Present and Future Research*, Vol. 15, Housing Policy Debate, pp512–513 (2004).

6 For a detailed timeline of key events in fair lending, see Fair Lending Timeline, Fried Frank (September 27, 2002), at www.ffhsj.com/fairlend/timtest.htm.

7 For a more detailed summary of the evolution of HMDA, see Joseph Kolar & Jonathan D. Jerison, *The Home Mortgage Disclosure Act: Its History, Evolution, and Limitations*, Buckley Kolar LLP (March 7, 2005), at http://www.buckleykolar.com/publications/documents/HomeMortgageDisclosureActbyJoeKolarandJonJerison.pdf.

8 For an overview of current HMDA reporting requirements, *see A Guide to HMDA Reporting: Getting it Right!*, Federal Financial Institutions Examination Council (December 2003), at http://www.ffiec.gov/hmda/pdf/2004guide.pdf.

9 In prior years, higher-cost loans were identified based on whether the originator was on a list produced by the U.S. Department of Housing and Urban Development (HUD) of predominantly subprime lenders. See *HUD Subprime and Manufactured Home Lender List*, U.S. Department of Housing and Urban Development (March 31, 2005), at http://www.huduser.org/datasets/manu.html. Although using lenders as a proxy for subprime loan status was useful, it risked some degree of misclassification since, for example, some predominantly prime lenders also originate subprime loans.

10 Alicia H. Munnell, Geoffrey M.B. Tootell, Lynn E. Browne & James McEneaney, *Mortgage Lending in Boston: Interpreting HMDA Data*, Vol. 86, No. 1, The American Economic Review pp25-53 (March 1996).

11 Critics of the Boston Fed study have suggested that the estimated impact on race and ethnicity could have been biased because of omitted variables, data errors, and potential problems with the model used. Nonetheless, the Boston Fed study remains one of the most comprehensive and robust analyses of discrimination in the mortgage market. For an excellent overview of the study and the critiques leveled against it, *see* Stephen L. Ross & John Yinger, *Does Discrimination in Mortgage Lending Exist? The Boston Fed Study and Its Critics*, *in Mortgage Lending Discrimination: A Review of Existing Evidence* (Margery Austin Turner & Felicity Skidmore, eds., The Urban Institute, June 1999), at http://www.urban.org/UploadedPDF/mortgage_lending.pdf.

12 *Curbing Predatory Home Mortgage Lending*, U.S. Department of Housing and Urban Development and U.S. Department of the Treasury (June 2000), at http://www.huduser.org/publications/hsgfin/curbing.html.

13 Calvin Bradford, *Risk or Race? Racial Disparities and the Subprime Refinance Market*, *Center for Community Change* (May 2002), at http://butera-andrews.com/legislative-updates/directory/Background-Reports/Center%20for%20Community%20Change%20Report.pdf.

14 Paul Calem, Kevin Gillen & Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, Vol. 29, No. 4, Journal of Real Estate Finance and Economics (December 2004).

15 As of March 1, 2005, lenders covered by HMDA were required to make their 2004 loan information available to the public within 30 days of receiving a request. While many lenders complied, sending electronic, easily accessible data to those who requested it, many others sent only hard copies, PDF files, or other formats that made it virtually impossible to conduct comprehensive analyses on national data. As a result, reports prior to the federal release of the data tended to focus on pricing disparities of specific lenders, not the market as a whole.

16 *The 2004 Fair Lending Disparities: Stubborn and Persistent*, National Community Reinvestment Coalition (April 2005), at http://www.ncrc.org/pressandpubs/press_releases/documents/HMDApricing_Report.pdf; The High Cost of Credit: Disparities in High-Priced Refinance Loans to Minority Homeowners in 125 American Cities, ACORN Fair Housing (September 27, 2005), at http://www.acorn.org/index.php?id=9753; and Allen Fishbein & Patrick Woodall, *Subprime Cities: Patterns of Geographic Disparity in Subprime Lending*, *Consumer Federation of America* (September 8, 2005), at http://www.consumerfed.org/pdfs/Subprimecities090805.pdf.

17 *See, e.g.*, *Experts: Prepare for Legal, Regulatory Fallout From HMDA Data*, Mortgage Banking (October 2005), at http://www.all-business.com/periodicals/article/606224-1.html.

18 Robert B. Avery, Glenn B. Canner & Robert E. Cook, *New Information Reported Under HMDA and Its Implication in Fair Lending Enforcement*, *Federal Reserve Bulletin* (Summer 2005), at http://www.federalreserve.gov/pubs/bulletin/2005/3-05hmda.pdf.

19 The Fed study uses mutually exclusive categories when comparing borrowers by race and ethnicity. Specifically, they compare African-Americans, regardless of ethnicity, to Hispanic whites and non-Hispanic whites.

20 Specifically, the disparity ratios of higher-rate lending to African-Americans to that of whites drops approximately 15% in both purchase (3.7 to 3.1) and refinance (2.7 to 2.3) loans. For Latino white borrowers, the ratio drops 17% (2.3 to 1.9) for purchase loans and only 7% (1.5 to 1.4) in the case of refinance loans. *See* Tables 10A and 10B, Avery *et al*, note 18, p34.

21 Even after both the borrower and lender adjustments, African-American borrowers remain 40% and 80% more likely than white borrowers to receive a higher-cost loan for refinance and purchase purposes, respectively. For white Hispanic borrowers, the corresponding increased likelihoods decrease but persist at 10% (1.1 times) and 30% (1.3 times). See Tables 10A and 10B, Avery *et al.*, note 18, p34.

22 We made this estimation by comparing loan volume in the proprietary database with several estimates of overall subprime mortgage volume from third parties.

23 *See* App. 1 for detailed information on our matching methodology.

24 *See* App. 2 for comparisons of average values of variables between the proprietary database and the merged dataset.

25 Specifically, we merged in information on Treasury and corporate bond rates from the Federal Reserve, state race and ethnic composition from the 2000 Census, and state housing price index from the Office of Federal Housing Enterprise Oversight (OFHEO). Categories of state laws with respect to judicial foreclosure and deficiency judgment were from Brent Ambrose, Michael LaCour-Little & Anthony Sanders, *The Effect of Conforming Loan Status on Mortgage Yield Spreads: A Loan Level Analysis*, Vol. 32, No. 4, Real Estate Economics, pp541-569 (2004).

26 *See* Ambrose *et al.*, note 25.

27 We eliminated any loans with FICO scores less than 300 or greater than 850, assuming that such scores were erroneous.

28 Unlike the Fed paper, the sample size in this research was not large enough to permit controlling for originating lender. Instead, we control for the regulating agency of the originating lender, which controls for the type of lender if not the specific originator.

29 Limiting our original dataset to loans in these four product categories yielded 93,659 loans. When further selections were made to ensure loans were secured by a first-lien, lacked private mortgage insurance, were below jumbo threshold, and were made to either a Latino, African-American, or white borrower, we were left with 50,031 loans.

30 Like the Federal Reserve analysis in Avery, et al., New Information Reported under HMDA and Its Application in Fair Lending Enforcement (see note 18), we exclude from the analysis all loans in which the loan application was submitted prior to January 1, 2004. We also exclude loans for which the variables race, ethnicity and sex were all coded as "not applicable" as these loans are presumed to be for commercial, agricultural, or business purposes.

31 Jumbo loans are loans above the maximum limit for purchase by Fannie Mae and Freddie Mac. In 2004, the maximum limit was $333,700 in most states. *See Fannie Mae Announces Higher 2004 Conforming Loan Limit of $333,700; Higher Limit Will Bring Mortgage Savings to More Americans*, Fannie Mae (November 25, 2003), at http://www.fanniemae.com/newsreleases/2003/2860.jhtml.

32 Odds ratios are the convention because the exponential of the coefficient produced by the logistical regressions is the odds ratio corresponding to a one-unit change in the variable.

33 *See* App. 5 for more detail about APR.

34 For a discussion of this sort of targeting, *see* Elizabeth Renuart, *Toward One Fair and Competitive Mortgage Market: Suggested Reforms in a Tale of Three Markets Point in the Right Direction*, Vol. 82 Texas Law Review p421*et seq.* (December 2003), and Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets Revisited*, Vol. 82 Texas Law Review p439 et seq. (December 2003).

35 *See* App. 5 for an explanation of how APR tends to understate the cost of fees for borrowers. *See, also*, National Consumer Law Center, *The Cost of Credit: Regulation, Preemption and Industry Abuses* § 5.5.2.2.1 (3rd Ed. 2005) (example of a small mortgage with 10 points at 15% note rate, 25% APR; prepaid at two years costs borrower equivalent of 29.5%--nearly double the note rate and almost 5% more than the APR).

36 2006 *Predatory Lending Update: Breaking News on the Federal, State, and Local Fronts and How It Impacts You*, Inside Mortgage Finance Publications (transcript of remarks by Iowa Attorney General Thomas J. Miller during April 20, 2006 audio conference).

37 *See* untitled press release, Federal Reserve System Board of Governors (May 27, 2004) (announcing $70 million Citigroup settlement), at http://www.federalreserve.gov/boarddocs/press/enforcement/2004/20040527/default.htm; *Citigroup Settles FTC Charges Against the Associates Record-Setting $215 Million for Subprime Lending Victims*, U.S. Federal Trade Commission (September 19, 2002), at http://www.ftc.gov/opa/2002/09/associates.htm; and Press Release, *Ameriquest Announces Agreement with States*, Ameriquest (January 23, 2006), at http://www.ameriquestmortgage.com/releaseArticle.html?news=news20060123.

38 We caution that, while the ranges of African-American-to-white and Latino-to-white disparities presented here appear to differ in magnitude, the 95% confidence interval of the underlying odds ratio estimates frequently overlap (e.g., for the nine odds ratios that are significantly different from 1 and associated with the Latino or African-American variables, eight of them have a 95% confidence interval including 1.55). In other words, while the estimates presented here are helpful, the magnitude of African-American-to-white disparities are largely indistinguishable from Latino-to-white disparities.

39 *See* discussion above in Section III. Also, we recognize that our analytic framework treats the risk factors on rate sheets as legitimate factors and assumes that borrowers are in loan types (e.g., adjustable-rate mortgages) that reflect their true preference. As such, our methods are unlikely to detect discriminatory effects that might result from using certain factors to measure risk when they more directly serve as a proxy for race or ethnicity or from attempts to influence borrowers to accept more costly products. Also, we note that while researchers have found that borrowers of color are disadvantaged in the mortgage application process, our methods would be unable to detect disparities resulting from such differences. For example, if a white applicant received assistance and consequently was able to submit a stronger application than an identically-situated borrower of color who did not receive the same assistance, then the application could lead to a loan with a lower rate even though there was no substantive difference in the borrowers' qualifications. Since our analyses use data collected after the application process, we cannot detect such patterns. *See* Margery Austin Turner, Fred Freiberg, Erin Godfrey, Carla Herbig, Diane K. Levy & Robin R. Smith, *All other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions*, *The Urban Institute* (April 2002) (reporting differences in pre-application treatment of white borrowers and borrowers of color by mortgage lenders), at http://www.huduser.org/Publications/PDF/aotbe.pdf.

40 "Yield-spread premium" is a term usually reserved for brokered transactions. In loans wholly originated by a lender, the same type of premium is usually referred to as an "overage."

41 We acknowledge that, in some instances, yield-spread premiums may play a helpful function, allowing borrowers to close their mortgage without any out-of-pocket costs or increase in the amount borrowed. In this scenario, lenders effectively provide a borrower with a credit in exchange for their agreement to pay a higher interest rate than their risk profile warrants. This credit is then applied to pay a broker or other loan originator's fee and other costs such as fees for an appraisal or title insurance.

42 For example, in a $250,000 loan originated by a large nationwide subprime lender through a broker and reported to the Center for Responsible Lending by the borrower, the broker received $5,000 in up-front fees that were financed into the amount borrowed, an additional $5,000 yield-spread premium, and the lender received an additional $1,282.50 in fees—and the borrower still had to pay other closing costs. These amounts total more than 4.5% of the loan amount, 13 times higher than the 0.36% average initial points and fees reported for single-family conventional loans in the first three months of 2006. For information on points and fees, see Table 1 of *Monthly Interest Rate Survey*, Federal Housing Finance Board (April 2006), at http://www.fhfb.gov/GetFile.aspx?FileID=4587. See, also, Kellie K. Kim-Sung & Sharon Hermanson, *Experiences of Older Refinance Mortgage Loan Borrowers: Broker- and Lender-Originated Loans*, (AARP Public Policy Institute Data Digest No. 83 (2003) (70% of older borrowers with broker-originated loans relied "a lot" on brokers to find the best mortgage for them, and of those with broker-originated loans, 21% reported they did not receive the best loan for them, as compared to 9% with lender-originated loans, and 20% received worse loans than expected, as compared to 8% with lender-originated loans).

43 For a discussion of the complexity of consumer shopping behavior, see Jack Guttentag, *Another View of Predatory Lending*, Financial Institutions Center, The Wharton School, University of Pennsylvania (revised August 21, 2000), at http://fic.wharton.upenn.edu/fic/papers/01/0123.pdf. *See also* James M. Lacko & Janis K. Pappalardo, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment*, Federal Trade Commission Bureau of Economics (February 2004) (documenting consumer confusion with *simplified* disclosures), at http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf; Patricia A. McCoy, *A Behavorial Analysis of Predatory Lending*, Vol. 38, Akron Law Review (2005); Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending.*, Vol. 14, Cornell Journal of Law & Public Policy, pp199, 229-239 (2005); Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, Vol. 13.2, Stanford Law & Policy Review (2002).

44 *See, e.g.*, the Georgia Fair Lending Act, which measures both yield spread premiums and prepayment penalties in its assessment of points and fees to determine whether a loan is high cost and deserving of additional protections. Ga. Code § 7-6A-1 *et. seq.*

45 Howell E. Jackson & Jeremy Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, pp121-129 (January 8, 2002), at http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf Annual Review of Banking (forthcoming 2005). Similar findings have been made in the context of similar rate-based mark-ups in the automobile financing setting. *See, e.g.*, Mark A. Cohen, *Report on the Racial Impact of GMAC's Finance Charge Markup Policy* (August 29, 2003) (reporting that African Americans paid "more than 2 _ times the amount in subjective markup compared to whites,"), at http://www.consumerlaw.org/initiatives/cocounseling/gmacreportbystate.shtml.

46 *See, e.g.*, White, note 5, pp510-11 (providing an example of a lender limiting YSPs to 1% of the loan amount in loans without prepayment penalties, 1.5% for loans with a one-year prepayment penalty, 2% for loans with a two-year prepayment penalty, and 3% for loans with a three-year prepayment penalty).

47 Debbie Gruenstein Bocian & Richard Zhai, *Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans*, Center for Responsible Lending (January 2005), at http://www.responsiblelending.org/pdfs/rr004-PPP_Minority_Neighborhoods-0105.pdf.

48 Rate sheets provided by lenders to brokers frequently provide an overall cap for such charges, but we are aware of none that explicitly determines these origination charges.

49 Marsha J. Courchane, Douglas McManus & Peter M. Zorn, *An Analysis of Mortgage Closing Costs* (August 2004) (unpublished manuscript quoted with permission, on file with authors).

50 *Brokers Flex their Muscle in 2005, Powering Record Subprime Year*, Inside B&C Lending (March 17, 2006).

51 *Service Remains the Key to Wooing Mortgage Brokers*, IMF Poll Finds, Inside B&C Lending (January 6, 2006).

52 *See* Turner *et al.*, note 39 (reporting differences in pre-application treatment of white borrowers and borrowers of color by mortgage lenders).

53 We note that while we were not able to control for the specific identity of lenders due to data limitations, we did include a variable to control for the identity of the lenders' primary federal regulator. This adjustment, in essence, should control for differences in cost of funds that result from corporate form (e.g., national bank versus non-depository state lender).

54 While it is theoretically possible that these lenders are competing in beneficial ways on dimensions other than price, the loan products selected for analysis in this paper are quite standard—to the point where we may consider them commodities—and, consequently, the findings cannot be readily explained by observing that the loans represent unique options for borrowers.

55 Paul S. Calem, Jonathan E. Hersaff & Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, Vol. 15, No. 3, Housing Policy Debate (2004), at http://www.fanniemaefoundation.org/programs/hpd/v15i3-index.shtml (reporting that borrower and neighborhood demographics are significant factors in determining whether a borrower receives a loan from a predominantly prime or a higher-cost, predominantly subprime lender). While not studying the role of race and ethnicity, recent research from Lax et al. shows that borrowers are not efficiently sorted between the prime and subprime sector and that up to one percentage point in interest rates charged in the subprime market could not be explained by risk. Howard Lax, Michael Manti, Paul Raca & Peter Zorn, *Subprime Lending: An Investigation of Economic Efficiency*, Vol. 15, No. 3, Housing Policy Debate, pp568-69 (2004), at http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Lax.pdf. In addition, Freddie Mac has publicly commented that more than one-in-five recent subprime borrowers in recent years could likely have qualified for a prime loan. Mike Hudson & E. Scott Reckard, *More Homeowners with Good Credit Getting Stuck with Higher-Rate Loans*, Los Angeles Times pA-1 (October 24, 2005). It stands to reason that such inefficiencies in borrower sorting might also be reflected in the present analysis that examines only the distribution of loans within the subprime sector.

56 William C. Apgar & Allegra Calder, *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending*, 2005 President and Fellows of Harvard College, W05-11, p1 (December 2005), at http://www.jchs.harvard.edu/publications/finance/w05-11.pdf.

57 In practice, HMDA regulations ensure among the broadest possible coverage of Latino borrowers. Under the rules, even in instances when such information is not provided by borrowers, lenders are required to report ethnicity, race, and gender "on the basis of visual observation or surname." See 12 C.F.R. § 203, App. B.

58 *See* Apgar *et al.*, note 56, pp4, 21.

59 Kim-Sung *et al.*, note 42.

60 William P. Alexander, Scott D. Grimshaw, Grat R. McQueen & Barrett A. Slade, *Some Loans Are More Equal than Others: Third-Party Originations and Defaults in the Subprime Mortgage Industry*, Vol. 30, No. 4, Real Estate Economics, pp667-697 (2002) (concluding that third-party originations are more likely to default and that they therefore carry a higher rate than retail originated loans). On this same point, Federal Reserve researchers examining the 2004 HMDA data reported that loans thought more likely to be brokered (because they were from outside of lenders retail assessment area established for Community Reinvestment Act purposes) were more likely to be high-APR loans. *See* Avery *et al.*, note 18.

61 *See* United States v. First American Bank (N.D. Ill.) (filed July 13, 2004) *and* United States v. Old Kent Financial Corporation and Old Kent Bank (E.D.S.D. Mich.) (filed May 19, 2004).

62 While lenders are screened for fair lending compliance, it is less clear that the lending patterns of affiliated lenders are scrutinized

on a consolidated basis. Indeed, the challenge of a review that would necessarily cut across regulatory agency lines is considerable. Consider the resources and coordination necessary to review an institution that has a bank holding-company structure, with a national bank (supervised by the Office of the Comptroller of the Currency), a state bank (supervised by a state regulator and the Federal Deposit Insurance Corporation), and a non-depository finance company (supervised by the Federal Reserve Board and a state regulator).

63 See e.g., Joint HUD/Treasury Report, note 12; Eric Stein, Quantifying the Economic Cost of Predatory Lending, Coalition for Responsible Lending (rev. October 30, 2001), at http://www.responsiblelending.org/pdfs/Quanr10-01.pdf; and Elizabeth Renuart, An Overview of the Predatory Lending Process, Vol. 15, No. 3, pp467-502 (2004) at http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Renuart.pdf.

64 Marsha J. Courchane, Brian J. Surrette & Peter M. Zorn, *Subprime Borrowers: Mortgage Transitions and Outcomes*, Vol. 29, No. 4, Journal of Real Estate Finance and Economics pp365-392 (2004).

65 The median net worth of non-white and Latino households was just 17.6% that of white households in 2004. Brian K. Bucks, Arthur B. Kinnickell & Kevin B. Moore, *Recent Changes in U.S. Families Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, Vol. 92 Federal Reserve Bulletin pA4 (February 2006).

66 See note 41.

67 15 U.S.C. § 1602(aa)(4)(D). Some courts have differed over whether YSPs are captured by the existing HOEPA definition of fees and points. *See generally*, National Consumer Law Center, *Truth in Lending* § 9.2.6.3.4 (5th Ed. 2003 and 2005 supplement).

68 *See, e.g.*, USA v. Delta Funding Corp., No. CV 00 1872 (S.D.N.Y Mar. 30, 2000), *available at* www.usdoj.gov. Cf. USA v. Long Beach Mortgage Co., No. CV 96-6159 (C.D. Cal., settlement agreement and order filed Sept. 5, 1996) (discriminatory pricing resulting from related originator compensation practices). For litigation involving YSPs and overages *see generally*, National Consumer Law Center, *The Cost of Credit: Regulation and Legal Challenges* §§ 11.5.4.3, 12.2.1.5.1 - .6 (RESPA), 12.5 (text accompanying notes 475-476); National Consumer Law Center, *Credit Discrimination*, §§ Chap. 8, 12.4.1.5

69 Christopher A. Richardson & Keith Ernst, *Borrowers Gain No Interest Rate Benefits from Prepayment Penalties on Subprime Mortgages*, Center for Responsible Lending (2005), at www.responsiblelending.org/pdfs/rr005-PPP_Interest_Rate-0105.pdf.

70 The majority of borrowers with subprime loans with prepayment penalties do in fact pre-pay. For example, a CRL internal analysis of California subprime loans orginated in 2003 showed that 71% had prepaid within 24 months, the average term for most prepayment penalties. This analysis utilized data from MBS offerings, courthouse records, and the proprietary database used here. Similarly, an analysis by Ralph DeFranco and Paul Calem, *Why Have Subprime Loans Been Prepaying so Fast?* (August 2005) at http://www.sme-online.com/sme/efeature/efeature0509.html/) shows that subprime loans nationally have comparable prepayment rates.

71 The extent to which prepayment penalties and YSPs are actually explained and offered as genuine options to borrowers in the subprime market is the subject of dispute in any event. For example, false, misleading or deceptive representations concerning prepayment penalties were among the issues present in the states' actions against both Household and Ameriquest, and consequently were the subject of injunctive relief in the settlements against both.

72 For a thoughtful discussion of suitability standards in the securities framework and their adaptability to the mortgage context, see Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, Vol. 80 Texas Law Review pp1317-1363 (May 2002) *and* Engel & McCoy, note 34, p440.

73 *See Brokers Flex their Muscle*, note 50.

74 *See, e.g.*, Patricia A. McCoy, Banking on *Bad Credit: New Research on the Subprime Home Mortgage Market*, Remarks at 2005 Federal Reserve Research Conference (July 26, 2005) (arguing for such an arrangement), at http://www.chicagofed.org/cedric/files/2005_conf_discussant_session1_mccoy.pdf.

75 *HMDA Targets Big Lenders on "Predatory" Loans*, Vol. 4, No. 6, Home Equity Wire (November 15, 2005).

76 *See, e.g.*, *Inner City Press' Community Reinvestment Reporter* (April 10, 2006), at http://www.innercitypress.org/crreport.html.

77 See Office of the Comptroller of the Currency v. Spitzer, 396 F. Supp. 2d 383 (S.D.N.Y. 2005), *appeal pending*.

78 *See* Li and Ernst, note 22, pp2, 11-14.

79 *See* Li and Ernst, note 22, pp3, 15-17.

80 *See, e.g.*, Ken Markison, Melissa Richards & Raymond Snytsheuvel, *Regulatory Update: Home Mortgage Disclosure Act (HMDA)*,

Ney-Kanjorski, RESPA Reform, State Predatory Lending and Licensing Laws, FACTA and FCRA, Data Security and RESPA Enforcement, Mortgage Bankers Association, PowerPoint presentation at MBA Residential Underwriting Conference 2005, at http://events.mortgagebankers.org/resundr2005/signatureconferences/resundr/images/img/Comprehensive.PPT.

81 Keith S. Ernst & Deborah N. Goldstein, *Comment on Federal Reserve Analysis of Home Mortgage Disclosure Act Data*, p5 (Sept. 14, 2005), at http://www.responsiblelending.org/pdfs/cb001-FRB-091505.pdf.

82 HMDA lenders were chosen to correspond to originators with more than 1,000 loans for 2004 in the proprietary database.

83 Though included in the matching process, jumbo loans and loans secured by manufactured housing ultimately were not included in the final analyses.

84 Because of a high incidence of missing lender names in the proprietary database, a loan was considered "non-unique" and removed if state, zip code, loan purpose, property type, lien status and loan amount were the same as another loan, regardless of the lender name.

85 Unlike HMDA, the proprietary database does not have a consistent format for the names of lenders. Therefore, we relied on key words in the lender identification fields of the two databases when matching the loans.

86 *See* LeadsToLoans at http://www.leadstoloans.com.

87 Beginning with the 2004 HMDA data, borrowers can report multiple racial categories. In addition, HMDA contains an ethnicity variable indicating whether the borrower is Latino that is distinct from the race variables. We coded any borrower who listed "Black or African American" as one or more of the racial designations as black regardless of how they identified their ethnicity. Similarly, we coded all borrowers who indicated their ethnicity was "Hispanic or Latino" as Latino, regardless of their racial categorization. Finally, we coded borrowers who chose only "white" in the racial categories and only "Not Latino or Latino" in the ethnicity category as "white." The remaining records were not coded into racial and ethnic categories and are excluded from the analysis.

88 While Ambrose *et al.* (note 25) included age as an independent variable in their interim models, we did not have that information. However, we included information not in the Ambrose model, such as level of documentation. In addition, we stratified our data by loan purpose, which Ambrose *et al.* did not. Finally, whereas Ambrose and his colleagues model only conforming fixed-rate loans, we also analyze adjustable rate loans, which dominated the subprime market.

89 HPI is the state quarterly Housing Price Index from OFHEO, and the subprime rate is the 30-year, B-credit, 80 percent LTV rate from *Inside B&C Lending*.

90 Unlike the LTV and origination amount variables, which are continuous, whether or not a loan had a prepayment penalty is binary. As a result, 3SLS cannot be used to correct for potential endogeneity between APR spread and prepayment penalty status. However, by running separate models for loans with and without prepayment penalties, any potential endogeneity is eliminated.

91 KS is a non-parametric statistic that measures the maximum deviation of empirical distribution between two samples. Here KS statistics provide a relative goodness-of-fit measurement of the logistic regression model. A model with KS statistics of 0 has no predictive power, a model with a KS statistics of 100 predicts the data perfectly, and good models tend to have a KS statistic greater than 50. For the "ALL" group, the KS statistic was calculated for all data in the model; for "Black," KS was calculated for the Black borrowers, etc. This is used to demonstrate that the model fits the data equally well for all racial and ethnic groups. See Lax et al., note 55.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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Consumer Federation of America

For Immediate Release:
Wednesday May 24, 2006

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NEW ANALYSIS OF NON-TRADITIONAL MORTGAGE BORROWERS SHOWS LESS WEALTHY, WEAKER CREDIT THAN INDUSTRY SUGGESTS

African Americans, Latinos More Likely to Receive Negatively Amortizing Mortgages

Washington, D.C. – As Americans struggle to become homeowners, the use of interest only and optional payment mortgages continues to increase. The burden of these "riskier" mortgages is falling on middle and moderate income borrowers with less than stellar credit scores according to new data released today in a study by the Consumer Federation of America. In addition, the analysis also found that African American and Latinos were more likely to receive payment option mortgages than whites and African Americans were more likely to receive interest only mortgages.

"While the lending industry has characterized non-traditional borrowers as financially sophisticated and savvy consumers, the truth is that many are far from affluent and could be betting the house on their mortgage," said Allen Fishbein, Director of Credit and Housing Policy at Consumer Federation of America (CFA). Because home ownership is so critically important in financial security, these Americans are unwittingly putting their entire financial livelihood at risk.

Over the past few years, the number of loan products available to homebuyers has exploded, but there is little understanding by many borrowers about how to compare or even understand the differences between these loan products. The new research findings appear in CFA's newly released study, *Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumers and Lenders*. CFA analyzed certain borrower and loan characteristics of more than 100,000 mortgages originated between January and October 2005. This data offers one of the first opportunities to examine characteristics of non-traditional mortgage borrowers.

Among the key findings:

- **Significant Shares of Non-Traditional Mortgage Borrowers Earn Less Than $70,000 Annually.** More than one third (36.9%) of interest only borrowers earned below $70,000 annually and about one in six (15.6%) earned under $48,000 annually. More than one third (35.0%) of payment option borrowers earned under $70,000 annually and about one in eight (12.1%) earned between under $48,000. ($70,000 was about the median for Atlanta, Philadelphia and Chicago metropolitan areas, according to HUD figures for 2005, and the national median is $44,300.)

- **African Americans and Latinos More Likely to Receive Payment Option Mortgages:** Latinos are **nearly** twice as likely as non-Latinos to receive payment option mortgages. One in fifty (2.1%) non-Latino borrowers received payment option mortgages compared to the 4.0% of Latinos that received payment option mortgages. African Americans were 30.4% more likely than non-African Americans to receive payment option mortgages. 2.2% of non-African Americans received payment option mortgages compared to 2.9% of African Americans.

- **African Americans were more likely than non-African Americans to receive interest-only** loans. Nearly one in ten (9.0%) of African Americans received interest-only mortgages, 11.7% higher than the 8.1% of non-African Americans that received interest-only mortgages.

- **Many Non-Traditional Borrowers Have Only Average or Even Weaker Credit Scores.** More than half (53.8%) of payment option borrowers and nearly two-fifths (38.0%) of interest only borrowers have credit scores below 700. More than one fifth (21.4%) and about one in eight (12.1%) interest only borrowers had credit scores below 660.

- **The majority of these two types of non-traditional mortgages are used to purchase homes.** Nearly four out of five (79.0%) interest-only mortgages and nearly three fifths (57.5%) of payment option loans were used to finance the purchase of a home. The high proportion of purchase mortgages in the non-traditional mortgage portfolio tends to support the contention that the increased use of these mortgage products is related to the rapidly escalating cost of housing.

The CFA research highlights that although these borrowers broadly have higher incomes and credit scores than borrowers overall, many have incomes and credit scores considerably below this. Especially considering that many of these loans are made in higher-income areas like Washington, DC and San Jose, where the area median incomes are higher, many of these borrowers are potentially below the median income.

Many borrowers are increasingly relying upon non-traditional mortgages as a means to buy homes they could not otherwise afford. Non-traditional mortgage products typically offer initial lower monthly payments than traditional fixed-rate loans. But when these loan terms reset after a brief period, usually 2 to 5 years, consumers could be vulnerable to payment shocks, making their homes suddenly unaffordable and potentially ruining their finances. A $200,000 home with adjustable rate (ARM) non-traditional mortgage, an interest only ARM payment would rise by 54% and a payment option ARM payment would rise by 123% if the interest rate rose from 5.00% to 6.50%.

"Non-traditional mortgages are more complex than your parents' home loan, and some highly leveraged or unsophisticated consumers could end up learning that the mortgage that helped them buy their home was a ticking time bomb that destroyed their finances for years," said Patrick Woodall, CFA's Senior Researcher.

The report examines the implications of the rapid rise of non-traditional mortgages and how these products pose additional risks for borrowers. Non-traditional mortgage products may benefit certain consumers, but pose more risks than benefits for many others. There are indications that many borrowers do not fully understand that these mortgages expose borrowers to potentially sharp increases in borrowing costs. Federal Regulators recently urged lenders to provide more comprehensive information to borrowers. However, given the array and complexity of many of the new products being offered, improved disclosures may not be enough. The plain fact is that deferred payment mortgage products simply may not be appropriate for all borrowers who receive them and therefore, a threat to homeownership sustainability. Suitability standards that protect borrowers from getting inappropriate mortgage products would be one solution CFA believes is worth considering.

CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education.

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Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumers and Lenders

Allen J. Fishbein
Patrick Woodall

May 2006

1. Introduction

There has been a proliferation of new mortgage products in recent years. Until even a few years ago, lenders offered essentially two mortgage products: fully amortizing, fixed rate and adjustable rate mortgages. In the past few years there has been an explosion of newer mortgage products which have never been a significant part of the mortgage market. Expanded borrower choice allows households to more carefully tailor their loans to their circumstances, but the expanded choices may be confusing to some borrowers who may not understand the implications of the wide variety of mortgages. Many of these new mortgage products will also expose some borrowers to payment shocks when their payments sharply increase when the terms of the loans change abruptly. As the FDIC pointed out in a consumer brochure in the summer of 2005, "Many new loan products are being widely offered that could benefit some people but be huge mistakes for others."[1]

Lenders have long offered more flexible mortgage products, but primarily they were offered only to upscale borrowers. Wealthier, sophisticated borrowers might opt for a mortgage with low monthly payments so they could capitalize on other investment opportunities.[2] Recently, changes in the mortgage market including the increased use of automated underwriting, credit scoring and risk-based pricing including subprime loans have allowed lenders to offer a broader range of products to more borrowers with a wider range of incomes and creditworthiness. Additionally, housing price escalation has made these loans seem less risky to lenders because the underlying asset was increasing in value.

On one hand, these changes have allowed more applicants to qualify for loans to purchase the homes they want. The non-traditional mortgages may be one important way for some borrowers to become homeowners.[3] However, consumers need to understand how these mortgage products work and how the terms of these mortgages will impact their families' finances over the lifetime of the mortgage. Many, including Consumer Federation of America, are justifiably concerned that the proliferation of new mortgage products is not appropriate for many borrowers who

[1] FDIC, "A Shopper's Guide to Bank Products and Services," *FDIC Consumer News*, Summer 2005.
[2] Teems, Yvonne, "The Interest-Only Mortgage Isn't Right for All Homebuyers," *Dayton Business Journal*, July 29, 2005.
[3] Joint Center for Housing Studies of Harvard, *The State of the Nation's Housing 2005*, 2005 at 18.

receive them and that over the long term these mortgages could threaten homeownership sustainability.

There is particular concern over the homeownership sustainability for more vulnerable consumers – first time homebuyers, unsophisticated financial consumers, and consumers traditionally underserved by the mortgage market, especially lower-income and minority consumers. These borrowers are less likely to understand their ability to negotiate mortgage terms, the complexity of the mortgage vehicles they are offered, and the long-term monthly payment variation between the different products now available on the market.

Additionally, the terms of some of these loans may mitigate some of the wealth-building effects of homeownership. Interest-only mortgages and payment option loans, which can negatively amortize, can mean that for the initial borrowing period, the wealth gain from the mortgage comes entirely from appreciating home prices and not from the repayment of the principal. If housing prices rise more slowly than they have recently or stagnate, these borrowers will have built little household wealth. If home prices fall, these borrowers could owe more in mortgage debt than their homes are worth.

Finally, the increase in the number of non-traditional mortgages could have implications for the lending industry. Although some thrifts have been offering some of these products for many years, many lenders are new to these products. Lenders who have specialized in these non-traditional mortgages could find that if a large number of borrowers face sharp payment shocks when their loans are recalculated after the initial low monthly payment rate, interest rates increase or housing prices slide, that the lenders have a larger number of non-performing loans on their books. The majority of non-traditional mortgages originated during 2004 and 2005 will season in 2006 and 2007, so consumers could start facing payment shocks soon. There are some financial analysts that are concerned that the credit scoring mechanisms that have been used to assess repayment and default risks for traditional 30-year mortgages may be ill suited to measure the risks of these emerging non-traditional mortgage products. Banking regulators have been warning the lending industry of such an eventuality more consistently than the regulators have been warning consumers about the risks of taking these more complicated financial products.

This paper examines the non-traditional mortgage market and its potential impact on borrowers and lenders. First, it describes the range of non-traditional mortgage products, their typical loan terms, market distribution and potential effects for consumers. Second, it examines the market conditions that have fostered non-traditional mortgage lending, the underwriting and credit implications of non-traditional mortgage lending for originators and the potential for payment shocks and defaults for borrowers. Third, it analyzes information gathered regarding the characteristics of non-traditional mortgage borrowers in terms of income, credit scores and loan-to-value ratios relative to all mortgage borrowers. Fourth, it lays out the key concerns over non-traditional mortgage borrowing for consumers and the housing market. Fifth, it discusses some actions that are needed to ensure that these products are not aggressively marketed to vulnerable consumers. Last, it discusses the proposed federal regulatory guidance on non-traditional mortgages.

2. The Variety of Non-Traditional Mortgage Products

Over the past few years, the number of loan products available to homebuyers has exploded, but there is little understanding by many borrowers about how to compare or even understand the differences between these loan products. The language the lending industry uses has contributed to this confusion, since the multiplying number of loan products are described by a multiplying number of labels or names. Even the broader industry description of "non-traditional" or "exotic" mortgages confers little information to average consumers at the same time that more people are paying closer attention to the real estate market since housing prices began to steeply appreciate.

Over the past fifty years, borrowers traditionally used loan products that were primarily either fixed rate or adjustable rate 30-year mortgages. Fixed rate mortgages had monthly payments which were constant for the duration of the mortgage; adjustable rate mortgages (ARMs) had monthly payments that would vary from month to month or year to year based on an interest rate index which moved with market interest rates.

Generally, what non-traditional mortgages have in common is that they feature lower initial monthly payments than do traditional fixed or adjustable rate mortgages. Interest-only, payment option, piggy-back, and low- or no-documentation loans are all non-traditional mortgages. These mortgages often combine the non-traditional features with newer adjustable rate mortgage features or with other non-traditional features. So it is not impossible to imagine a low-documentation, interest-only hybrid ARM that permits negative amortization. These layered risk combinations only serve to concentrate the risk to the borrower and the lender. John Dugan, Comptroller of the Currency, noted, "There is no doubt that when several risky features are combined in a single loan, the total risk is greater than the sum of its parts."[4]

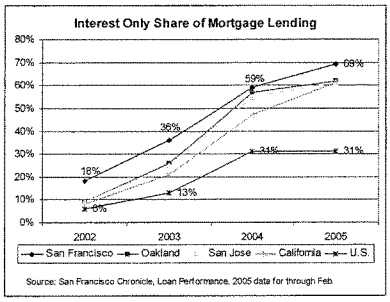
Interest-only mortgages (I/O Loans) allow borrowers to defer payment of principal and thus pay only the monthly interest on their mortgages for a set period of time (usually 1, 3, 5 or 10 years) after which the borrowers must pay down (or amortize) their mortgage at a faster rate. Payment option (or option ARMS or pick-a-payment mortgages) allow borrowers to choose their monthly payment structure – either amortizing, interest-only or minimum payment (which is often even lower than the monthly interest payment). This may be somewhat familiar to consumers because it is similar to the way credit card bills are presented – a minimum payment which makes little if any dent in the principal of the consumer loan. Hybrid ARMs start as fixed rate mortgages which convert to adjustable rate mortgages after an initial period and thus offer the prospect of higher monthly payments should interest rates rise. Piggyback (no money down, 80/20, or 80/10/10 loans) allow borrowers to purchase a home with little or nothing down and without requiring private mortgage insurance. Lenders have recently been offering mortgage products which help borrowers avoid the costs of paying PMI by making an 80 percent of the home price traditional mortgage and a 10 percent second lien for borrowers with a 10 percent down payment or in some cases with a 20 percent second lien mortgage to make the down payment to the seller. Low-documentation, no-documentation or Alt-A loans are alternative qualification standards

[4] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, Georgia, October 27, 2005 at 6.

where borrowers pay a premium for lenders to approve mortgages for applicants who do not present detailed proof of income or assets that traditionally have been required; borrowers certify their income instead. These products are discussed at some length below.

Interest-Only Mortgages (I/O Loans)

Interest-only mortgages have recently become increasingly popular, especially in real estate markets with skyrocketing prices. However, interest-only mortgages are not new; they were common in the 1920s. At that time, most mortgages were interest-only loans for their entire terms (usually less than 10 years), so borrowers did not amortize the loan at all and had to refinance the loan at the end of the term.[5] Homeowners used their money to invest in the stock market prior to the 1929 market crash rather than paying down their debt.[6] When real estate prices collapsed during the Great Depression, interest-only foreclosures spiked and lenders stopped making interest-only loans for the next seven decades.[7]



Interest-only loans were once niche products used for cash flow management purposes by upscale borrowers. More recently, they have been promoted in many markets as a way for cash-strapped borrowers to afford homes or afford larger homes than their incomes would ordinarily permit under traditional lending guidelines. Many interest-only borrowers will have initial monthly payments about 20 percent lower than for a traditional amortizing loan.[8] According to data from Loan Performance, interest-only borrowers tend to have higher down payments than other borrowers, meaning they have a larger equity stake in the property.[9]

Interest-only loans are a growing share of the mortgage market. Loan Performance has reported that interest-only mortgages made up nearly one third of mortgage originations in 2004 and 2005.[10] Almost one fifth (18%) of loans in securitized mortgage portfolios in 2004 were interest-only loans worth $324 billion.[11] In some markets with high real estate prices, even higher shares of mortgages were interest-only loans. In California, interest-only loans grew more than sevenfold from 8% in 2002 to 61% in 2004.[12] In 2004, more than half of the borrowers in Orange County, California used interest-only mortgages, up from only 3 percent in 2001.[13] In

[5] Guttentag, Jack, "New Interest-Only Mortgage Loans Can be Quite Risky," *USA Today*, May 14, 2005.
[6] Weston, Liz Pulliam, "Could you Handle an Interest-Only Loan?" *MSN Money*, February 2004.
[7] "Interest-Only Mortgages Gain Believers, Skeptics," *Knight-Ridder*, July 10, 2002.
[8] Updegrave, Walter, "Starting with an Interest-only Loan," *CNN/Money*, June 29, 2005.
[9] Zito, Kelly, "High Interest in Interest-Only Home Loans," *San Francisco Chronicle*, May 20, 2005.
[10] Joint Center for Housing Studies of Harvard, *The State of the Nation's Housing 2005*, 2005 at 17; Pasha, Shaheen, "Housing Bubble May Lose Some Wind," *CNN/Money*, October 21, 2005.
[11] Fratantoni, Michael, Mortgage Bankers Association, "Housing and Mortgage Markets: An Analysis," MBA Research Monograph Series No. 1, September 6, 2005 at 56.
[12] Zito, Kelly, "High Interest in Interest-Only Home Loans," *San Francisco Chronicle*, May 20, 2005.
[13] Lansner, Jonathan, "Riskier Loans Stir Up Interest," *Orange County Register*, April 12, 2005.

Washington, DC, more than a third of new mortgages in the first half of 2005 were interest-only loans, up from only 2% in 2000.[14]

Interest-only loans are being marketed to consumers as a way to leverage their purchasing power, but consumers may not understand the implications of choosing an interest-only loan. Some real estate agents are encouraging families to take out interest-only loans as a way for families with tight budgets to get over the homeownership hurdle of rising home prices. In an interview with ABC7 News in the San Francisco Bay area, Vivian Rivera from Paragon Mortgage in California recommended, "If you are just getting into a home and you really need every single edge you can get, then an interest rate only loan is the way to go."[15] In a 2004 survey, Consumer Federation of America found that young adults, Latinos, lower-income and less educated consumers are the most attracted to and least informed about interest-only mortgages.[16]

Initially, interest-only loans are not much different than fully amortizing loans during the opening years of a mortgage, because even for fully amortizing mortgages the majority of monthly payments are predominantly interest for the first few years. Consequently, households that are able to move to a new home or refinance their mortgages before the amortizing period of the mortgage kicks in can benefit. Households that relocate frequently or are planning on moving before the amortizing principal payments kick in might benefit from interest-only loans. Borrowers who are in school might benefit from low monthly payments while they are enrolled in class, but they could afford the payment increases once they were in the workforce.[17]

However, borrowers who are not in a position to refinance when the interest-only period ends will face a jump in monthly mortgage payments which can be quite steep. When the interest-only period on the mortgage ends, the increase in the monthly payments (known as payment shock) could be so large that some borrowers may not be able to afford their mortgage payments.[18] After the interest-only period ends the loan converts into a fully amortizing mortgage, but because of the years of interest-only payments, it amortizes more quickly and the payments are higher than a 30-year amortizing mortgage. Some borrowers are receiving interest-only adjustable rate mortgages, so when their loan starts to amortize, the interest rate could significantly increase at the same time, making the monthly payments much higher.[19] In the first half of 2005, nine out of ten interest-only loan originations were adjustable rate loans.[20]

Interest-only loans are also being marketed to borrowers with less than perfect credit. These subprime borrowers are more vulnerable to payment shocks than prime borrowers. The Comptroller of the Currency is concerned that the mass marketing of IOs to subprime borrowers

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[14] Henderson, Nell, "Concerns Raised as Home Sales, Prices Rise Again," *Washington Post*, September 27, 2005.
[15] "Financing Options for Home Buyers," ABC7, KGO-TV, April 6, 2005.
[16] Consumer Federation of America, "Lower-Income and Minority Consumers More Likely to Prefer and Underestimate the Risks of Adjustable Rate Mortgages," press release, July 26, 2004.
[17] Teems, Yvonne, "The Interest-Only Mortgage Isn't Right for All Homebuyers," *Dayton Business Journal*, July 29, 2005.
[18] Weisser, Cybele, "Crazy Loans: Is This How the Boom Ends?" *Money Magazine*, September 16, 2005.
[19] Guttentag, Jack, "New Interest-Only Mortgage Loans Can be Quite Risky," *USA Today*, May 14, 2005.
[20] Mortgage Bankers Association, press release, "Mortgage Originations Rise in First Half of 2005; Demand for Interest-only, Option ARM and Alt-A Products Increases," October 25, 2005.

can create significant payment shock for many borrowers who are not prepared for the payments to spike.[21] Syndicated real estate columnist Kenneth Harney has called interest-only mortgage products "one of the most toxic to the unwary."[22]

Many borrowers are now trying to refinance their loans before their amortizing payments begin. However, with rising interest rates and many homeowners having cashed out much of their homes' equity, lenders may be reluctant to offer credit on affordable terms and it could be difficult to secure a refinance loan.[23] Moreover, refinance loans could lead to additional costs from fees that are charged by lenders. Some interest-only borrowers may be forced to sell their homes before the amortizing payments begin. Even in stagnant or flat housing markets, interest-only loans could be costly for borrowers. If a borrower sells before making any principal payments and the home has not appreciated more than the cost of the real estate sales commission or transaction costs (typically about 6% of the sales price), the homeowner could end up having to pay those costs out of pocket.[24] In the third quarter of 2005, the median sales price for existing home sales was $215,000, which would mean that sellers would need nearly $13,000 to pay for real estate commissions to sell their house.[25] These potential refinance or resale difficulties are ignored by desperate buyers and glossed over by realtors and mortgage brokers who are pushing these products.

Interest-only mortgages may be appropriate for some borrowers, but the rapid increase in the proportion of interest-only mortgages suggests that they may be being over promoted to borrowers. Because interest-only loans appear to be marketed in some cases based on a borrower's ability to make initial monthly payments, CFA is concerned that borrowers may not adequately understand the long-term implications of the cost of the loan or the potential difficulty in refinancing. Since many of these loans will convert to rapidly amortizing mortgages within a few years, some of these borrowers could face difficulty in paying their mortgages. If these borrowers fall behind on their loans when the interest-only period ends, their credit scores would be negatively impacted, it would become more difficult and costly to refinance the loan, and they could face foreclosure.

Pay Option, Option ARMs or Pick-a-Payment Mortgages

Payment option mortgages allow borrowers to choose the amount they pay each month – from a fully amortizing payment, an interest-only payment or a minimum payment that is lower even than the amount of an interest-only payment. Payment option mortgages once were offered only to wealthy borrowers who could manage the costs and risks of these loans, but recently the loans have been push-marketed as "affordability products" for households to become homeowners in

[21] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, Georgia, October 27, 2005 at 7.
[22] Harney, Kenneth R., "Interest-Only Loans are Potential Time Bombs," July 3, 2004.
[23] Haddad, Annette, "Risky 'Exotic' Loans Fostering Refi Cycle," *Los Angeles Times*, October 10, 2005.
[24] Teems, Yvonne, "The Interest-Only Mortgage Isn't Right for All Homebuyers," *Dayton Business Journal*, July 29, 2005.
[25] National Association of Realtors press release, "Home-Price Appreciation Stays Hot in Most Metro Areas," November 15, 2005.

rapidly appreciating real estate markets.[26] A 2005 *Wall Street Journal*/Harris Interactive poll found that overall 4 percent of households had a payment option mortgage.[27] However, option ARMs have been an increasing component of mortgage originations during the first half of 2005. In the first five months of 2004, less than one in twenty mortgages were option ARMs, but in the first five months of 2005 option ARMs made up 25% of prime and Alt-A mortgages.[28]

Option ARMs became more prevalent in 2005, but as the housing market started to cool and interest rates rose, the demand for option ARMs slowed by the end of the year. By mid-2005, the Mortgage Bankers Association estimated that option ARMs constituted about 10 percent of mortgage loans.[29] The lenders that have specialized in option ARMs saw their option ARM volume fall to about a third of mortgages in the third quarter of 2005 from about 40 percent in the previous year or previous quarter.[30]

The lowest payments actually increase the size of the borrower's mortgage obligation, as the deficit between what the borrower pays and owes is added to the mortgage debt. This is especially likely when the option ARM's teaser rates expire. Teaser rates are the lower rates lenders offer to make mortgage products more attractive to borrowers focused on initial monthly payments, and option ARMs typically offer their products at 200 basis points below the prevailing market rate.[31] When the teaser rates expire, the lender raises the interest rate, but not the minimum payment requirement, so the borrower who makes only minimum payments will be accumulating additional debt from the higher interest rates which are not covered by the minimum payments. Less financially sophisticated borrowers could enter these mortgages unwittingly. Borrowers can be lured into these mortgages with initial teaser interest rates that can be as low as one percent but last only a few months.[32] One lender that specializes in option ARMs, Golden West Financial's Herb Sandler, noted recently that some lenders are not fully explaining or disclosing the risks of option ARMs and "are clearly faking their borrowers out."[33]

Although borrowers can choose to repay their loan under a number of options, the majority of borrowers are only making the smallest possible payments. Some industry analysts estimate that 70 percent of option ARM borrowers are currently making only the minimum payments.[34] Fitch Ratings reports that a significant number of new option ARMs immediately begin to negatively amortize upon origination.[35] To date, payment option mortgages have been primarily marketed

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[26] Dugan, John C., Comptroller of the Currency, Remarks before the Consumer Federation of America, December 1, 2005 at 10.
[27] Bright, Becky, "A Third of U.S. Homebuyers Use Creative Mortgages Poll Finds," September 9, 2005.
[28] Office of Thrift Supervision, "Option ARMS: Part One," *The Quarterly Review of Interest Rate Risk*, Vol. 10, Iss. 2, Second Quarter, 2005 at 3.
[29] Ambrose, Eileen, "Option ARMs Often Are Poor Choice for Buying a Home," *Baltimore Sun*, August 1, 2005.
[30] Simon, Ruth, "A Trendy Mortgage Falls from Favor," *Wall Street Journal*, November 29, 2005.
[31] Office of Thrift Supervision, Examination Handbook, Section 212C.1, Negatively Amortizing Mortgages, June 2005.
[32] Simon, Ruth, "A Trendy Mortgage Falls from Favor," *Wall Street Journal*, November 29, 2005.
[33] Eisinger, Jesse, "Investors Fret Mortgage Balloons Will Burst," *Wall Street Journal*, July 27, 2005.
[34] Simon, Ruth, "A Trendy Mortgage Falls from Favor," *Wall Street Journal*, November 29, 2005.
[35] Fitch Ratings, "U.S. Residential Mortgage Products: Only Time Will Tell," September 22, 2005 at 4.

to borrowers with strong credit scores. However, as the popularity of the mortgage product increases, it is likely that option only mortgages will be marketed to subprime borrowers.[36]

The unique terms of payment option mortgages are particularly dangerous for the least sophisticated borrowers and for borrowers with less than pristine credit records. Comptroller Dugan has warned lenders not to aggressively market payment option loans arguing that "Lenders should not encourage or accept applications from borrowers who clearly cannot afford the dramatically increased payments."[37] The Comptroller of the Currency reports that half of the least creditworthy option ARM borrowers have mortgage balances that exceed their original loan amount.[38] Moreover, it is no longer just affluent borrowers who are using payment option mortgages to maintain financial flexibility. Borrowers from all portions of the credit score spectrum are utilizing option payment mortgages, with riskier borrowers using these mortgages the most frequently.[39]

A borrower making only the minimum payment can see the principal grow by about 2.5% over the course of a year.[40] Although lenders have been willing to make non-traditional mortgages because of the rapid real estate price increases, average real estate price appreciation over the long-term has been modest. Between 1975 and 1995, real single family home prices increased 0.5% per year and during the real estate price boom subsequent to 1995, real home prices increased 3.6% per year.[41] This means that even if home price appreciation remains at the level of the past decade, some of the home price appreciation would be consumed by the increasing size of the loan because of negative amortization. If real estate appreciation slowed to more reasonable historic levels, minimum payment borrowers would add to their debt each year.[42]

Most option ARMs require borrowers to start paying down the mortgage if the mortgage negatively amortizes too much (typically if the principal grows to more than 110-125% of the original loan). Increasing the size of the mortgage hurts borrowers in a rising interest rate environment because their monthly payment rises even faster – the principal grows while the mortgage interest rate adjusts up at the same time.[43] If real estate prices decline, payment option borrowers will not be able to use refinancing or resale as an escape hatch to avoid payment shocks.[44] For median priced existing homes, a 10 to 25 percent increase in the mortgage balance would add $21,500 to $53,750 to the homeowner's debt. Even if home price appreciation

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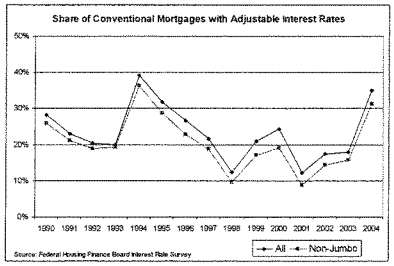
[36] Remarks by John C. Dugan, Comptroller of the Currency, Before the Consumer Federation of America, December 1, 2005, at 10.
[37] Remarks by John C. Dugan, Comptroller of the Currency, Before the Consumer Federation of America, December 1, 2005, at 12.
[38] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, Georgia, October 27, 2005 at 7.
[39] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, Georgia, October 27, 2005 at 7.
[40] Simon, Ruth, "A Trendy Mortgage Falls from Favor," *Wall Street Journal*, November 29, 2005.
[41] Himmelberg, Charles, Christopher Mayer and Todd Sinai, "Assessing High House Prices: Bubbles, Fundamentals, and Misperceptions," Federal Reserve Bank of New York Staff Report no. 218, September 2005 at 1.
[42] The increasing principle figure is not adjusted for inflation so it is not exactly comparable to the housing price appreciation figure.
[43] Eisinger, Jesse, "Investors Fret Mortgage Balloons Will Burst," *Wall Street Journal*, July 27, 2005.
[44] Remarks by John C. Dugan, Comptroller of the Currency, Before the Consumer Federation of America, December 1, 2005, at 11.

exceeds the mortgage debt, to resell the home, the owner could be required to pay as much as six percent to real estate brokers or agents in closing costs, leaving homeowners to pay the difference.

The complexity of payment option mortgages and the considerable risk they could pose to homeownership sustainability make these loans poor choices for many borrowers. Although the borrowers will ultimately have to repay these increased mortgage balances, if the principal has grown significantly, borrowers may be forced into default which will destroy their credit rating.[45] The Office of Thrift Supervision has warned that rising interest rate shocks could lead a substantial number of homeowners to default at the same time, which harms individual families and could pose risks to lenders.[46] These risks could be especially acute for minimum payment borrowers when they are forced to start repaying their principal after a few years of negative amortization at the same time housing prices slumped. As Julie Williams, Chief Counsel at the Office of the Comptroller of the Currency noted, "If housing prices enter a period of decline, borrowers could wind up with a depreciating asset backing a rising loan balance – a recipe for potential trouble for them and their lenders."[47]

Developments in the Adjustable Rate Mortgage (ARMs) and Hybrid ARM Market

To date, lenders have not been aggressively marketing payment option and, to a lesser extent, interest-only mortgages to the subprime market, but the borrowers with compromised credit histories and lower incomes have been increasingly utilizing adjustable rate mortgages (ARMs) as affordability tools. These mortgages also can have significant payment shocks, particularly for borrowers with limited income flexibility as the mortgages adjust. Moreover, subprime borrowers taking ARM products (over 80 percent of the subprime market) assume greater interest rate risk than prime ARM borrowers because their loans typically have higher interest rates than prime notes. The most common subprime ARMs adjust after the first two years, which could further compound financial strain on some borrowers should interest rates rise during this period.



Adjustable Rate Mortgages or ARMs are mortgages with interest rates which are pegged to a prevailing interest rate index. When interest rates rise, the interest rate on one's mortgage increases and so does the monthly payment, but when prevailing interest rates fall, so do one's mortgage payments. The adjustments to the interest rate are typically capped so that the interest rate cannot rise more than a certain amount at any given adjustment or for a total over the life of

[45] Dugan, John C., Comptroller of the Currency, Remarks before the Consumer Federation of America, December 1, 2005 at 7.
[46] Office of Thrift Supervision, "Option ARMs: Part One," *The Quarterly Review of Interest Rate Risk*, Vol. 10, Iss. 2, Second Quarter, 2005 at 4.
[47] Julie Williams, Chief Counsel and First Senior Deputy Comptroller, Office of the Comptroller of the Currency, Remarks Before the Canisius College School of Business, Buffalo, September 14, 2005.

the loan. With fixed-rate mortgages, lenders earn more from borrowers than the marketplace when the prevailing rates are lower than the fixed mortgage rate and earn less if the prevailing interest rates are higher than the mortgage rate. With ARMs, this risk is transferred to the borrowers, who will forgo the stability of monthly payments under a fixed-rate mortgage for the chance that interest rates will decline making their future payments potentially lower. ARM borrowers face the risk that future interest rates will rise and they will have to pay more each month to cover the higher interest on their mortgage.

Some ARMs adjust from the outset of the mortgage by readjusting every year or another fixed period, and others start adjusting after a fixed period, known as hybrid ARMs. The most common ARMs in the prime market are the so-called 5/1 ARMs which start adjusting after five years and adjust annually every year after. Hybrid ARMs made up nearly three quarters (72%) of all adjustable rate mortgages in the second quarter of 2004, up from a low of about a third (32%) of adjustable mortgages in the fourth quarter of 2000.[48]

Generally, borrowers are more likely to want fixed-rate mortgages when interest rates are low to lock-in the best rates possible. The share of mortgages that are ARMs has been increasing in recent years as the interest rates have risen, perhaps with the hope that in the future interest rates might return to the three decade lows of the late 1990s and early 2000s. In 2001, 12.2% of conventional mortgages had adjustable rates, but by 2004 more than a third (35.0%) of conventional mortgages had adjustable rates, nearly a three-fold increase in four years.[49]

It is unusual for borrowers to shift to ARMs when there is a widespread perception that interest rates will rise. However, despite successive increases in the Federal Funds Rate by the Federal Reserve, both fixed and adjustable mortgage rates have not risen appreciably. Since July 2004 when the Fed began raising interest rates, the conventional fixed mortgage interest rate has hovered around 6 percent. However, the adjustable rate mortgage interest rate has been creeping up from 3.56% in March 2004 to 5.30% in November 2005.[50] For example, if a borrower took out a 3-year hybrid ARM in January 2003 at the prevailing rate of 4.26% on an average sized existing home with a 10% down payment ($215,000 home with a $193,500 mortgage) the payments would have been $954 a month for the past three years but would rise to $1,074 in January (if rates remain about where they were in November at 5.30%). This is why most borrowers avoid ARMs when interest rates are rising.

CFA has found that lower-income and minority consumers were more likely than other consumers to prefer ARMs but they were less likely to understand the risks.[51] More than three fifths of young adults, African Americans, Latinos, those with incomes below $25,000, and those without a high school diploma did not know how to estimate what would happen to monthly mortgage payments if interest rates rose two percentage points. Those who were willing to estimate the increased monthly costs underestimated the increase by between 40-50 percent. A

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[48] Fahey, J. Noel, Fannie Mae, "The Pluses and Minuses of Adjustable-Rate Mortgages," *Fannie Mae Papers*, Vol. iii, Iss. 4, December 2004 at 3.
[49] Federal Housing Finance Board, Monthly Interest Rate Survey.
[50] HSH Associates, National Monthly Mortgage Statistics, 1995 to 2005.
[51] Consumer Federation of America, "Lower-Income and Minority Consumers More Likely to Prefer and Underestimate the Risks of Adjustable Rate Mortgages," press release, July 26, 2004.

January 2006 Federal Reserve study found that significant numbers of ARM borrowers did not understand the reset period, the rate cap or the terms of their mortgages. It found that more than a third (35%) of ARM borrowers did not know the value of the reset interest rate cap and more than two in five (44%) did not know how to calculate the lifetime interest rate cap.[52] It is likely that this lack of knowledge has helped encourage borrowers to take out loans based on their initial repayment schedule without appreciating the possible risk of rising interest rates and increased monthly costs.[53]

Borrowers who are basing their mortgage decision on the initial monthly payment level could face significant payment shock as soon as the mortgage adjusts. For a median-priced existing home with a 10% down payment at the current 5.32% interest rate for 5/1 ARMs, the monthly payment would be $1,069.71.[54] If interest rates adjusted to 7.5%, the monthly payment would rise to $1,352.98, or a nearly $300 or 26.5% increase. In the late 1980s, interest rates rose to 10.25%.[55] If interest rates adjusted to that high level, the monthly payment on a median-priced home would rise to $1,733.96 – a 62.1% increase. A March, 2006 survey by the *Los Angeles Times/Bloomberg* found that one quarter (26%) of homeowners with adjustable rate mortgages were not confident that they could continue to make their mortgage payments if rates adjusted upwards in the future.[56]

ARMs are also offered with an initial lower interest rate to encourage borrowers to choose an ARM over a fixed rate mortgage. The initial teaser rates can be significantly lower than the 30-year fixed interest rates and ARM rates because currently ARM rates are close to fixed mortgage rates. The teaser rates revert to the ARM index rate at the first adjustment period, which means the first adjustments for ARM borrowers are almost certain to be increases in the interest rate and thus increases in the monthly payments. Borrowers who do not understand that their initial rate is a concessionary rate and that their rates will jump at the first adjustment (especially borrowers with the shortest adjustment periods) will likely face sharp increases in cost at the first adjustment.[57] The readjustment dates are looming for many ARMs. More than $200 billion worth of ARMs will adjust in 2006 and more than $1 trillion will adjust in 2007.[58]

The payment shock is especially worrisome for the subprime ARM borrowers. By the first quarter of 2005, more than half of subprime borrowers had adjustable rate mortgages compared

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[52] Bucks, Brian and Karen Pence, Federal Reserve Board of Governors, "Do Homeowners Know Their House Values and Mortgage Terms?" January 2006 at 19.
[53] Fahey, J. Noel, Fannie Mae, "The Pluses and Minuses of Adjustable-Rate Mortgages," *Fannie Mae Papers*, Vol. iii, Iss. 4, December 2004 at 2.
[54] National Association of Realtors, Median Sales Price of Existing Single-Family Homes for Metropolitan Areas, Third Quarter 2005; "5/1 Interest-Only ARM Rates Remain Unchanged in the United States Monday," *Bankrate*.com, November 28, 2005.
[55] Porter, Eduardo, "Good New, Bad News: Your Loan's Approved," *New York Times*, August 28, 2005.
[56] *Los Angeles Times/Bloomberg* Poll, "Undercurrent of Concern Amid General Optimism About Home Values and Personal Finances," March 7, 2006 at 26.
[57] Fahey, J. Noel, Fannie Mae, "The Pluses and Minuses of Adjustable-Rate Mortgages," *Fannie Mae Papers*, Vol. iii, Iss. 4, December 2004 at 10.
[58] Fratantoni, Michael, Mortgage Bankers Association, "Housing and Mortgage Markets: An Analysis," MBA Research Monograph Series No. 1, September 6, 2005 at 54.

to about fifteen percent of prime borrowers.[59] The concentration of ARMs and hybrid ARMs among subprime borrowers has additional risk of payment shock because these borrowers already have higher interest rates, so subsequent increases will be more difficult to afford.[60]

Piggyback, No Money Down, Simultaneous Second, or 80/20, 80/10/10 Loans

Mortgage lenders traditionally required borrowers to make down payments of at least 20 percent of the real estate purchase price to qualify for a loan. Borrowers who cannot put 20 percent down on their home purchases are typically required to buy private mortgage insurance (PMI) which insures the lender against the risk of borrower default. For years, borrowers with high incomes who had their wealth tied up in investments were able to receive no down payment loans.[61] Over the past fifteen years, the proportion of loans that have been made to borrowers making small down payments has increased significantly. In 1990, less than 3 percent of borrowers made down payments smaller than 5 percent, but the share of low or no down payment mortgages has grown more than fivefold to about 16-17 percent after 2000.[62] The National Association of Realtors reported last year that 43% of first-time homebuyers purchased homes with no-money down (compared to 28% of all homebuyers).[63] About half of all mortgages currently being written are either piggyback or lower-documentation loans.[64]

Lenders have recently been offering mortgage products which help borrowers avoid the costs of paying PMI by making a first-lien mortgage covering 80 percent of the home price, financed with a fixed rate, or increasingly, an ARM. The second lien loan is used to cover an additional 10 percent or even the remaining 20 percent to cover the down payment to the lender. The second mortgage is either a closed-end loan, or more often, an open-ended Home Equity Line of Credit (HELOC) with an adjustable rate. In 2004, three fifths (41.7%) of home purchase mortgage borrowing utilized piggyback loans, and by the first half of 2005 the proportion of borrowing using piggyback mortgage loans rose to nearly half (48.2%).[65] The average piggyback loan for home purchase was $46,000, or about 20 percent of average existing home prices.[66] A 2005 *Wall Street Journal*/Harris Interactive poll found that 4 percent of households had used a piggyback mortgage.[67] These no-downpayment mortgages have higher interest rates to compensate lenders for the additional risk.[68]

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[59] Fratantoni, Michael, Mortgage Bankers Association, "Housing and Mortgage Markets: An Analysis," MBA Research Monograph Series No. 1, September 6, 2005 at 46.
[60] Fahey, J. Noel, Fannie Mae, "The Pluses and Minuses of Adjustable-Rate Mortgages," *Fannie Mae Papers*, Vol. iii, Iss. 4, December 2004 at 4.
[61] Gaynor, Pamela, "Homeowners May Be Mortgaging Their Future with New Loan Products," *Pittsburgh Post-Gazette*, July 31, 2005.
[62] Joint Center for Housing Studies of Harvard, *The State of the Nation's Housing 2005*, 2005 at 17.
[63] Tse, Tomaeh Murakami, "Down Payment's Downward Trend," *Washington Post*, January 21, 2006.
[64] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, October 27, 2005 at 6.
[65] SMR Research, press release, "More People Use Scant Downpayments to Buy Homes, New Study Finds," August 16, 2005.
[66] Greenspan, Alan and James Kennedy, Federal Reserve Board, "Estimates of Home Mortgage Originations, Repayments, and Debt on One-to-Four-Family Residences," Finance and Economics Discussion Series, 2005-41, September 2005 at 11.
[67] Bright, Becky, "A Third of U.S. Homebuyers Use Creative Mortgages Poll Finds," September 9, 2005.
[68] Esswein, Pat Mertz, "A Mortgage for Every Buyer," *Kiplinger's*, August 2005 at 86.

Borrowers who rely on 80/20 mortgages could be pinched if the value of their home is steady or declines if they want to sell, because they will have built up very little equity.[69] FDIC noted that, when mortgaging the entire value of a home, "the risk of losing your home increases substantially and there's no margin for error."[70] One advantage is that the interest rate payments on the second mortgage (though not the principal) are tax deductible, compared to PMI premiums which do not receive tax benefits.[71] Piggyback borrowers could also end up upside down in their homes if housing prices declined within a few years of purchasing their homes. Borrowers who make down payments can survive small fluctuations in the real estate market, but borrowers who owe 100 percent of the value of their homes could owe more than their homes are worth even with minor downturns in the real estate market.

Low-Documentation, No-Documentation or Alt-A Loans

Lenders are increasingly approving mortgages for applicants who do not present the detailed proof of income or assets that traditionally have been required. In 2004, more than a quarter million conventional home purchase loans were originated to borrowers whose income was not disclosed. These borrowers represent 4.3% of all originations, which is only slightly below the 5.3% of originations to borrowers with incomes below 50% of the metropolitan area median income.[72] These loans benefit applicants who have volatile incomes such as those who work on commission, the self-employed or those who earn most of their money from bonuses.[73] In theory, small business owners who have assets but less ability to project earnings are able to vouch for their own incomes or provide minimal detail as to their incomes. For example, applicants might provide gross revenue figures for their small business but not net earnings or profits. These no documentation or low documentation loans (known as no-doc or low-doc mortgages) were historically very uncommon.

Many are concerned that a large number of low-doc borrowers may pose higher credit risks to lenders, especially if interest rates rise and housing prices fall.[74] There is some anecdotal evidence that lenders and brokers may be using low- no-doc loans to qualify borrowers who could not get the loans through traditional underwriting standards.[75] One anecdote shared in a *Motley Fool* column described a mainstream, unnamed lender that allegedly instructed an applicant to "Go ahead and just leave the application mostly blank; we'll fill it in."[76] To compensate for this risk, lenders charge higher interest rates for low- or no-doc loans.[77]

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[69] Weisser, Cybele, "Crazy Loans: Is This How the Boom Ends?" *Money Magazine*, September 16, 2005.
[70] FDIC, "A Shopper's Guide to Bank Products and Services," *FDIC Consumer News*, Summer 2005.
[71] "How Some Nontraditional Mortgages Work," *Associated Press*, October 8, 2005.
[72] Federal Financial Institution Examination Committee, Home Mortgage Disclosure Act National Aggregate Table 4-2, 2004.
[73] Joint Center for Housing Studies at Harvard, *The State of the Nation's Housing 2005*, 2005 at 18.
[74] Rozens, Aleksandrs, "Lenders Push Envelope to Get More Biz," *Associated Press*, November 23, 2005.
[75] Fratantoni, Michael, Mortgage Bankers Association, "Housing and Mortgage Markets: An Analysis," MBA Research Monograph Series No. 1, September 6, 2005 at 48.
[76] Jayson, Seth, "H is for Housing. And Hiss," *Motley Fool*, November 28, 2005.
[77] Joint Center for Housing Studies of Harvard, *The State of the Nation's Housing 2005*, 2005 at 18.

Lenders could be exposed to some risk from these loans if they have offered too many of them to borrowers who would not otherwise be deemed creditworthy to receive mortgages. In essence, lenders making mortgages on this basis use substitute assumptions in analyzing the borrower's capacity to repay the loan, such as lower LTVs or debt-to-income ratios. The fact that some of these borrowers are receiving other non-traditional mortgage terms on their loans and this layering of risk could be pose greater risks for lenders than anticipated.

All of these non-traditional mortgage products may have their proper uses. However, at the same time, non-traditional mortgages present genuine risks to borrowers who may not have the capacity to afford the payment shocks when these loans recalibrate and monthly payments rise. Additionally, just as these types of mortgages pose greater risk for consumers, they also pose greater risks to credit quality if they are not properly underwritten.

3. The Face of the Changing Mortgage Market

The shift to non-traditional mortgages of all types has been facilitated by three broad trends in the mortgage lending and real estate market. First, rapidly escalating real estate prices have encouraged households to leverage their purchasing capacity by choosing more flexible loans with lower monthly payments. Rising housing prices have also encouraged lenders to originate mortgages to more marginal borrowers, because the risk is balanced against an asset that is rising in value. This change is a double edged sword for consumers: it helps get families into homes or into larger homes, but it subjects them to a potentially steep payment shock when their non-traditional mortgages reset. Second, lenders are offering more tempting mortgage products to compensate for the decline in refinance mortgage originations as a result of the rising interest rate environment. Third, a series of technological changes in the lending industry has allowed lenders to more efficiently estimate risk and offer a wider range and variety of mortgage products tailored to the borrower.

The primary motivation for these new mortgage products is the rapidly escalating cost of housing which makes it more difficult for prospective homeowners, especially first time homebuyers, to make down payments as well as monthly mortgage payments. Most of the non-traditional mortgages have been written in strong real estate markets where there is an expectation of continued home price appreciation.[78] Higher home prices mean that new homeowners seek more flexible mortgage products to ensure that their monthly payments are affordable, but most of these products have payment structures which increase over time so the affordable initial payments could become significantly higher. Additionally, low interest rates and more flexible terms have led more homebuyers to purchase larger and more expensive homes which have put upward pressure on home prices. This cycle creates added demand for non-traditional mortgages – as more buyers use non-traditional mortgages to purchase more expensive homes, driving up prices and forcing more buyers to utilize non-traditional mortgages.[79]

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[78] Gaynor, Pamela, "Homeowners May Be Mortgaging Their Future with New Loan Products," *Pittsburgh Post-Gazette*, July 31, 2005.

[79] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, Georgia, October 27, 2005 at 6.

A September 2005 Harris poll found that one in five (19%) buyers purchased homes above their anticipated price range.[80] First time homebuyers who do not have equity from a previous home to make a down payment are often pushed into non-traditional mortgages in order to purchase a home.[81] Alan Greenspan testified to Congress in July 2005 that "Some households may be employing these instruments to purchase homes that would otherwise be unaffordable."[82] The Harvard Joint Center for Housing Studies suggests that the recent rapid increase in the use of interest-only mortgages demonstrates that an increasing number of families have reached the outer limits of housing affordability.[83] In a speech in October 2005, Federal Reserve Board Governor Susan Bies referred to non-traditional mortgages as "affordability" mortgages.[84]

Secondly, these new loan products help to maintain what would be a flagging demand for new mortgages. The rising interest rate environment has dampened the demand for new refinance mortgages, but the newer products with low initial payments have sustained loan volume over the past two years.[85] Since total loan volume is expected to stall or decline over the next few years, lenders are offering more flexible and initially affordable mortgages in an effort to compete for a declining pool of customers.[86] Additionally, more flexible loans which are easier to qualify for larger mortgages are helping lenders to bolster demand for new purchases and maintain loan volume as the real estate market cools.[87]

Third, the lending industry is offering these products with more risk than standard fixed-rate mortgages in part because of changes in the industry. First, transaction costs for mortgages have declined rapidly over the past decade. Mortgage fees and points have fallen from 1.10% of mortgages in 1994 to 0.40% in 2004, a 63.6% decline.[88] Second, the increased use of more sophisticated credit scoring devices has allowed lenders to better assess the risks of their loans – although these new scoring methods have yet to be tested in a high interest rate and falling real estate price environment.[89] Third, the evolution of automated underwriting standards helped to rapidly and accurately price different mortgage products for different consumers.[90] Fourth, the increasingly sophisticated modeling software allows lenders to look at each borrower individually for a wide range of loan products, terms and options.[91]

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[80] Gullo, Kelly, Harris Interactive, "Nearly One in Five Recent Homebuyers Purchased a Home That Exceeded Their Price Range," Vol. 1, Iss. 3, September 16, 2005.
[81] Porter, Eduardo, "Good News, Bad News: Your Loan's Approved," *New York Times*, August 28, 2005.
[82] Testimony of Alan Greenspan, Chairman of the Federal Reserve, before the Committee on Financial Services, U.S. House of Representatives, July 20, 2005.
[83] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2005*, 2005 at 2.
[84] Bies, Susan Schmidt, Governor, Federal Reserve Board, Remarks at the National Bankers Association Convention, Beverley Hills, California, October 12, 2005.
[85] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, Georgia, October 27, 2005 at 6.
[86] Haviv, Julie, "Housing is Hot, But Types of Loans Seen Cooling," *Reuters*, July 14, 2005.
[87] Rozens, Aleksandrs, "Lenders Push Envelope to Get More Biz," *Associated Press*, November 23, 2005.
[88] Federal Housing Finance Board, Monthly Survey of Rates and Terms on Conventional Single-Family Non-farm Mortgage Loans, Table 1.
[89] Weisser, Cybele, "Crazy Loans: Is This How the Boom Ends?" *Money Magazine*, September 16, 2005.
[90] Fratantoni, Michael, Mortgage Bankers Association, "Housing and Mortgage Markets: An Analysis," MBA Research Monograph Series No. 1, September 6, 2005 at 73.
[91] Yipp, Pamela, "Borrowers' Buffet," *Dallas Morning News*, July 25, 2005.

Concerns About Underwriting and Credit of Non-Traditional Mortgages

Non-traditional mortgages also may present underwriting concerns and credit risks for lenders since there is little long-term experience with the current concentration of non-traditional mortgages. Although some thrifts have experience with some of the non-traditional loan products, the broader lending industry has never marketed the current volume or concentration of non-traditional mortgage products. The new mortgage products "have the potential to take risk to a higher level than bank managers may be accustomed to" because of their inexperience with the new mortgage products over time, according to FDIC Director John M. Reich.[92]

Additionally, because of the intense competition for borrowers after the steep decline in refinancing when interest rates rose, lenders have been willing to accept more risk to drive originations. The overcapacity in the lending industry has encouraged the mortgage lenders to weaken their lending standards to compete for borrowers.[93] As Comptroller of the Currency John C. Dugan noted, "We're at the top of the credit cycle and banks naturally gravitate towards more risk."[94] Accurate assessment of credit risk of financial institutions is vital, because credit risk has been the leading cause of bank failures and remains the largest risk for most financial institutions.[95]

The 2005 federal regulators survey of underwriting found that banks had broadly and extensively eased their lending standards.[96] Larger lenders are making and holding more non-traditional mortgages than smaller banks. The Federal Reserve survey of lenders found that nearly a third (32.1%) of large banks estimated that non-traditional mortgages were more than 25% of their originations over the past year, but only 11.1% of smaller lenders made that many non-traditional loans.[97] Two thirds (67.8%) of large banks reported making more non-traditional mortgages over the past year than the previous year and no banks reported making fewer non-traditional mortgages compared to the previous year.[98]

Non-traditional mortgages require much more extensive application of meticulous underwriting standards, especially assessing the borrower's long-term ability to afford monthly payments.[99] The concentration of non-traditional mortgages by some lenders and the application of layered risk (notes with more than one non-traditional mortgage characteristic) requires lenders to assess

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[92] Speech by John M. Reich, Director, Office of Thrift Supervision, Before the Community Bankers Association of New York State, Naples, Florida, November 18, 2005 at 4.
[93] Speech by John M. Reich, Director, Office of Thrift Supervision, Before the Community Bankers Association of New York State, Naples, Florida, November 18, 2005 at 5.
[94] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, October 27, 2005 at 2.
[95] Remarks by Federal Reserve Governor Susan Schmidt Bies, At the National Bankers Association Annual Convention, Beverly Hills, October 12, 2005.
[96] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, October 27, 2005 at 3.
[97] Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices at Selected Large Banks in the United States," July 2005.
[98] Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices at Selected Large Banks in the United States," July 2005.
[99] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, October 27, 2005 at 8.

borrower risk more carefully and to monitor the loans over time to ensure that borrowers' risk profile and underwriting has not worsened. Non-traditional mortgage products combined with loosened underwriting standards pose higher risks for default.[100] Office of Thrift Supervision Director Reich noted:

> "All other things being equal, these products harbor more risk than traditional mortgages. That additional risk needs to be managed and ameliorated by the application of sound underwriting practices and strong risk management systems together with complete disclosure of not only the benefits of these products but also the risks they pose for the borrower."[101]

There are concerns that lenders are focusing on credit scores alone to assess the creditworthiness of borrowers without taking into account the borrower's ability to repay the note over the length of the mortgage.[102] This risk also needs to be understood and monitored as changes affect the mortgage and real estate market. The FDIC Risk Analysis Branch recently reported to the FDIC Board of Directors that credit losses on poorly underwritten non-traditional mortgages could "increase significantly" as interest rates rise and the housing market cools.[103] Alan Greenspan testified before Congress that "It is important that lenders fully appreciate the risk that some households may have trouble meeting monthly payments as interest rates and the macroeconomic climate change."[104] As OTS Director, Reich believes that it is important for regulators and consumers to distinguish between the challenges borne by new entrants into non-traditional lending field with those of thrifts with long term experience in providing these types of loans. "Thrifts have offered adjustable rate mortgages (ARMs) for more than thirty years," said Reich, "And thrifts have offered – and successfully managed – ARMs with negative amortization features for twenty years."[105]

The payment shocks associated with non-traditional mortgages could have credit risks for lenders. For example, lenders typically book even minimum loan payments as income even if the payments do not cover the amount due. When these negatively amortizing loans come due, with significant payment shocks to the borrowers, lenders may have to write loans down or off if borrowers cannot surmount the payment shock.[106] These payment shocks could happen within the next few years on the rising number of non-traditional mortgages that have been originated in the past few years. The FDIC estimates that the majority of the non-traditional loans

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[100] Remarks by Federal Reserve Governor Susan Schmidt Bies, At the National Bankers Association Annual Convention, Beverly Hills, October 12, 2005.
[101] Speech by John M. Reich, Director, Office of Thrift Supervision, Before the Community Bankers Association of New York State, Naples, Florida, November 18, 2005 at 5.
[102] Remarks by Julie L. Williams, Chief Counsel and First Senior Deputy Comptroller, Office of the Comptroller of the Currency, Remarks Before the Canisius College School of Business, Buffalo, September 14, 2005 at 6.
[103] FDIC Division of Insurance and Research, Risk Analysis Branch, "Economic Conditions and Emerging Risks in Banking: A Report to the FDIC Board of Directors," November 1, 2005.
[104] Testimony of Chairman Alan Greenspan, Federal Reserve Board's Semiannual Monetary Policy Report to the Congress, Before the Committee on Financial Services, U.S. House of Representatives, July 20, 2005.
[105] Speech by John M. Reich, Director, Office of Thrift Supervision, Before the Community Bankers Association of New York State, Naples, Florida, November 18, 2005 at 5.
[106] Remarks by John C. Dugan, Comptroller of the Currency, Before the Consumer Federation of America, December 1, 2005, at 2.

underwritten in 2004 and 2005 will season in 2006 and 2007 when the borrowers will face higher payments.[107]

The flexible approach that is used to facilitate non-traditional mortgage customized underwriting for each borrower may have limitations. Traditional credit scoring may not be entirely suited to measuring a borrower's ability to repay the new, non-traditional mortgages. For example, some of the non-traditional mortgages allow borrowers to forgo paying down the balance of the mortgage for an initial period. These borrowers would be reported as current to the credit bureaus, even though they would be considered delinquent and a credit risk if they failed to pay down any of the principal on a traditional mortgage.[108] Because these loans are considered current, they are not deemed to be risks, but a silent risk for lenders is building nonetheless as borrowers may become decreasingly able to repay their notes, especially when their loan payments are readjusted.[109]

Some believe that the risk posed by non-traditional mortgages is mitigated by mortgage securitization, but most lenders that originate non-traditional mortgages do not sell them on the secondary market. Fannie Mae and Freddie Mac have not been securitizing non-traditional mortgages, in part because the risk that these loans may end up in foreclosure conflicts with their mission to promote homeownership.[110] Ratings firm Standard & Poor's reported that fewer than 3 percent of Freddie Mac's retained mortgage portfolio was interest-only or payment option mortgages.[111] Less than 2 percent (1.8%) of the dollar value of mortgage-backed securities Freddie Mac issued in the first three quarters of 2005 were interest-only or payment option mortgages.[112] Surveys have shown that banks are significantly less likely to securitize non-traditional mortgages than traditional mortgages and instead keep these loans in their portfolios.[113] Bear Stearns estimates that interest-only and option ARM loans constitute a little less than 10% of the total securitization market. As a result, depository lenders that carry these loans on their books will face the entirety of the risk of delinquency and default. However, although non-traditional mortgages that are securitized protect banks that sell these mortgages from their portfolios, the secondary market absorbs part of the risk that the lenders sell. Recently, Standard & Poor's reported that the private residential mortgage backed securities will have the market's second-best year, but "increasing risks presented by the recent popularity of affordability products could contribute to deteriorating credit quality in the coming year."[114]

Although non-traditional mortgages may pose no risk for some borrowers who have the financial wherewithal and sophistication, some of the borrowers may have difficulty handling the payment shocks inherent in many of these mortgages. In that event, the credit risk shifts from the

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[107] Federal Deposit Insurance Corporation, "Economic Conditions and Emerging Risks in Banking: A Report to the FDIC Board of Directors," November 1, 2005

[108] Fitch Ratings, "U.S. Residential Mortgage Products: Only Time Will Tell," September 22, 2005 at 5.

[109] Remarks by Julie L. Williams, Chief Counsel and First Senior Deputy Comptroller, Office of the Comptroller of the Currency, Remarks Before the Canisius College School of Business, Buffalo, September 14, 2005 at 5.

[110] Sichelman, Lew, "GSEs Wary of 'Exotic' Mortgages," *Realty Times*, August 24, 2005.

[111] Standard & Poor's, RatingsDirect, Research: Freddie Mac, November 30, 2005 at 4.

[112] Freddie Mac, *Mortgage Funding: Gold Perspective*, Winter 2005, at 4.

[113] Remarks by Julie L. Williams, Chief Counsel and First Senior Deputy Comptroller, Office of the Comptroller of the Currency, Remarks Before the Canisius College School of Business, Buffalo, September 14, 2005 at 4.

[114] "Daily Mortgage Briefing," *National Mortgage News*, January 20, 2006.

borrower to the lender that originated the loan or whoever owns the mortgage securities. There is genuine concern by all federal banking regulators that lenders may be overly-sanguine in marketing the appropriateness of the mortgage for every consumer, carefully considering underwriting standards, and monitoring the mortgages as they begin to mature and readjust their payment schedules. The credit and underwriting risk posed to lenders by non-traditional mortgages may be significant, but it certainly would increase if the housing market stalled or declined and if interest rates continue to rise.

Potential Payment Shocks for Consumers from Non-Traditional Mortgages

Many borrowers are choosing these mortgages as the result of the rising housing costs and these non-traditional mortgages have lower initial monthly payment structures which leverage borrowers' capacity to afford homeownership. However, because many of these loans have terms which recast after a period to higher monthly payment structures, consumers could be vulnerable to payment shocks which could make their homes suddenly unaffordable and could compromise the financial stability of their households. Consumers should not be choosing mortgages based on the outside limits of their ability to afford the initial payments because most of these new mortgages will restructure their payments after an initial period and they are likely to become more expensive. Not only are stretched consumers seeking these loans, some lenders are qualifying borrowers based on their ability to make the initial monthly payments without regard to their inability to make rising payments later in the life of the mortgage.[115] A recent Mortgage Bankers Association research brief noted that "There is an overriding belief that borrowers are overly focused on finding the mortgage that has an initial payment that will get them into a property, while ignoring potential payment shocks down the road."[116]

Borrowers who utilize these mortgages to stretch their payment dollars ultimately have three options when their payment abruptly rises: cover the monthly increases which can be significant; refinance their loan into a fixed rate that still may have higher payments than their initial non-traditional mortgage payments, or sell their homes. None of these options are very attractive and all involve some costs to consumers. If interest rates continue to rise, refinancing may not even be possible for all homeowners, especially if the real estate market stalls or contracts. If little or no principal has been paid on the mortgages before the homeowners sell them and their homes have not appreciated more than 6%, some borrowers may have to pay additional amounts to real estate brokers. Additionally, many loans have penalties for borrowers who sell or refinance too quickly to ensure that the lender is able to recover costs and potentially earn a profit on the loan. A Bear Stearns analysis found that many serial refinancers only move into loans with riskier terms – from hybrid ARMS (with initial fixed rates) to interest-only loans to pick-a-payment option ARMs.[117]

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[115] Eisinger, Jesse, "Investors Fret Mortgage Balloons Will Burst," *Wall Street Journal*, July 27, 2005.
[116] Fratantoni, Michael, Mortgage Bankers Association, "Housing and Mortgage Markets: An Analysis," MBA Research Monograph Series No. 1, September 6, 2005 at 42.
[117] Haviv, Julie, "Housing is Hot, But Types of Loans Seen Cooling," *Reuters*, July 14, 2005.

For a $200,000 loan, the monthly payment increase for different loan products can vary significantly when the loan is recast at higher interest rates. Monthly payments on a payment option ARM with a 5.00% interest rate would more than double if the interest rate were reset at 6.50% and would be one and a half times higher if the note were reset at 8.00%, an interest rate that was seen as recently as 2000. Monthly payments on a 5/1 interest-only ARM would rise by half at 6.5% and rise by three quarters if the note were reset at 8.00%. Monthly payments for a 5/1 ARM without non-traditional features would nonetheless increase by 16% if the loan were reset at 6.5% and rise by one third if the note recast at 8%.

Monthly Loan Payments for Different Types of $200,000 Mortgages

Interest Rate	30-Year Fixed	5/1 ARM	5/1 Interest-only ARM	Option Arm
5.00%	$ 1,104	$ 1,074	$ 875	$ 643
6.50%	$ 1,104	$ 1,244	$ 1,350	$ 1,472
Monthly Increase	$ -	$ 170	$ 475	$ 829
	0.0%	15.8%	54.3%	128.9%
8.00%	$ 1,104	$ 1,422	$ 1,544	$ 1,652
Monthly Increase	$ -	$ 348	$ 669	$ 1,009
	0.0%	32.4%	76.5%	156.9%

5/1 ARMs are at 5.25% for first 5 years then reset to scenario rate, Option ARM has a 1-month teaser rate of 1.0%, then resets to scenario rate. Payment option rate capped at 7.5% and negative amortization limit of 110%.

Financial analyst Fitch Ratings has written that sophisticated borrowers with strong financial positions can benefit from non-traditional mortgages, but that borrowers who are choosing these mortgage products to maximize affordability could end up losing their homes because of payment shocks and erosion in their home's equity.[118] Additionally, consumers could face additional problems to their credit ratings if the payment shocks cause them to miss or make late mortgage payments. Mortgage delinquency or foreclosure has very negative implications on a household's credit rating which could prevent or make refinancing or a subsequent home purchase prohibitively expensive.

Prospects for Increased Non-Traditional Mortgage Defaults and Foreclosures

There are two basic risks to these more flexible mortgage arrangements, especially those that are designed to minimize monthly payments at the beginning of the loan. First, most of these products have low initial payments which can jolt upwards over the term of the loan – often rising more than consumers expect or understand. If borrowers are unprepared to handle higher monthly payments, they may not be able to keep up the payments on their mortgages and may face the risk of foreclosure. As former-FDIC Chairman Donald Powell noted in a speech to community bankers in October 2005, "Homeowners taking on these types of mortgage products need to understand how their obligation may grow when their introductory rates expire."[119] The risk is especially high for lower-income borrowers, as Federal Reserve Board Governor Susan Bies noted "These borrowers are more likely to experience an unmanageable payment shock at some point during the life of the loan, which means they may be more likely to default on the loan."[120]

[118] Fitch Ratings, "U.S. Mortgage Products: Only Time Will Tell," September 22, 2005 at 3.
[119] "Risky Mortgages May Harm Borrowers, Banks," *Associated Press*, October 18, 2005.
[120] "Fed's Bies Warns on Mortgage, Real Estate Lending," *Reuters*, February 2, 2006.

Secondly, low initial payments could backfire on homeowners if home prices fall. Over the past few years, non-traditional mortgage products have been promoted as low-risk because the rising housing market was effectively building equity for the new homeowner even if the borrowers did not pay down the principal of the mortgage. One California mortgage broker described many prospective borrowers' attitudes as "Why knock ourselves out trying to build up equity through the mortgage payments when the market will take care of it for you?"[121] However, recent borrowers have not been growing the equity in their new homes because of the range of non-traditional mortgages products with non- or negatively amortizing terms. First American found that nearly a third (29 percent) of loans that closed in 2005 had zero or negative equity by the start of 2006.[122]

If real estate prices decline slightly (as some project in several especially hot real estate markets), homeowners who have been only paying the interest or a tiny amount of their principal could end up owing more on their mortgage than their home is worth.[123] In the summer of 2005, Alan Greenspan warned that borrowers with non-traditional mortgages would be extremely vulnerable if housing prices slump; that "could be disastrous" for some families.[124] There are some early signs that this may already be happening. RealtyTrack, an online foreclosed property marketplace, reported in February that the national foreclosure rate was 45 percent higher in January 2006 than the previous January and that foreclosure rates in Florida, Nevada and Colorado (which all have had high levels of non-traditional mortgages) were up sharply from the previous month.[125] In certain California markets with high concentrations of non-traditional mortgages, foreclosure rates in the fourth quarter of 2005 were much higher than in the previous year. In San Diego and Orange County, foreclosures grew by more than a third (34.5 and 34.2 percent respectively) between the fourth quarter of 2004 and the fourth quarter of 2005, and foreclosures in San Francisco grew by 45.2 percent over the same period.[126]

Recent Focus Group Findings on Non-Traditional Mortgages

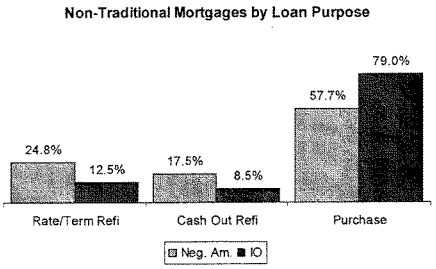
In the fall of 2005, Public Opinion Strategies performed focus group research on consumer attitudes on non-traditional mortgages that found that households were forced to take on non-traditional housing costs because of high housing costs but were surprised at the magnitude of the payment shock when these non-traditional loans reset. The focus group examined consumers earning below and above $75,000 year; the lower-income segment were more resigned to taking out non-traditional loans and more surprised by the payment shock. It found that lower-income participants did not believe traditional, fixed rate mortgages were even an option for them and that they were essentially forced to use non-traditional mortgages because of the high cost of housing.[127] The upper-income group viewed non-traditional mortgages as one in a range of mortgage product choices and these consumers understood the terms of the different types of

[121] Pender, Kathleen, "High Interest in Interest-Only Home Loans," *San Francisco Chronicle*, May 20, 2005.
[122] Harney, Kenneth R, "Equity Stake in Your Home: What Percentage?" *Realty Times*, February 27, 2006.
[123] Zito, Kelly, "Home Value Declines Seen as More Likely," *San Francisco Chronicle*, July 29, 2005.
[124] Aversa, Jeannine, "Fed Chief Warns About Mortgages," *Associated Press*, July 24, 2005.
[125] RealtyTrac press release, "National Foreclosures Increase 27 Percent in January According to RealtyTrac U.S. Foreclosure Market Report," February 21, 2006.
[126] DataQuick News, "California Foreclosure Activity Up," February 2, 2006.
[127] Public Opinion Strategies, Memorandum: Focus Group Observations, September 29, 2005 at 1.

mortgages available on the market today.[128] It also found that when consumers are shown the rate sheet with the various mortgage options they are surprised by the magnitude of the payment shock. Although upper-income focus group participants are less surprised, lower-income participants described the payment shock on the rate sheet as "shocking" and they were largely unaware of the size of the payment shock.[129] These lower-income consumers also were less informed about the payment shock and debt risks of non-traditional mortgages, with some noting the "wish they had known more."[130] All of the lower-income segment in one of the studied cities said that the higher payments after the mortgage recast would create a financial hardship for their families, and three quarters of them were concerned about their ability to make the monthly mortgage payments when the payments increased after the loan recast.[131]

4. The Characteristics of Non-Traditional Mortgage Borrowers

Recent media and industry reports suggest that a large number and share of mortgages are non-traditional mortgages, but there has been little information about the makeup of the borrowers. Although the lending industry and consultants have suggested that these borrowers have better credit scores and are wealthier, there has been little analysis of the borrowers who take out non-traditional mortgages. Consumer Federation of America analyzed certain borrower and loan characteristics for a database of more than 100,000 mortgages originated between January and October 2005. This data included whether the loans were interest-only or payment option as well as certain debt and creditworthiness information that is not contained in the Home Mortgage Disclosure Act dataset. CFA's examination of these mortgages found that more than one tenth of mortgages were either interest-only (8.1%) or payment option loans (2.3%).



Generally, but not universally, these borrowers did have higher incomes than borrowers overall, but their credit scores were not necessarily higher than borrowers overall. Many borrowers around the median income and with moderate credit scores are receiving interest-only and payment option mortgages. Moreover, African American and Latino borrowers are more likely to receive interest-only and payment option mortgages than non-minority borrowers at all levels of income, debt loads and credit scores.

The majority of these two types of non-traditional mortgages are used to purchase homes. Nearly four out of five (79.0%) interest-only mortgages and nearly three fifths (57.5%) of payment option loans were used to finance the purchase of a home. About one in five interest-only loans were refinance loans, while one eighth (12.5%) of interest-only loans were to improve the rates or terms of the mortgage and 8.5% of interest-only loans were cash out refinance loans.

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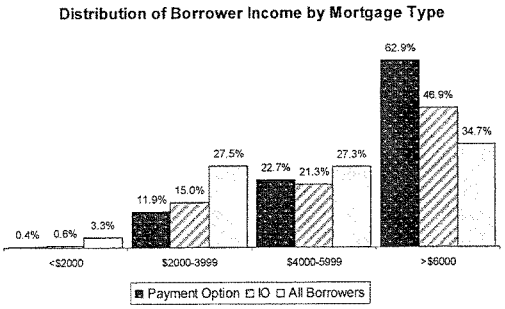
[128] *Ibid* at 2.
[129] *Ibid* at 3.
[130] *Ibid* at 3.
[131] *Ibid* at 4.

Payment option mortgages were used more frequently for refinance loans. Nearly one quarter (24.8%) of payment option mortgages were rate or term refinance loans and nearly a fifth (17.5%) were cash out refinance mortgages.

The high proportion of purchase mortgages in the non-traditional mortgage portfolio tends to support the contention that the increased use of these mortgage products is related to the rapidly escalating cost of housing.

The Distribution of Incomes of Non-Traditional Mortgage Borrowers

The interest-only and payment option borrowers are primarily upscale borrowers and they are more likely to be wealthier than overall mortgage borrowers. More than half (50.4%) of these non-traditional mortgage borrowers earned more than $6,000 each month. This represents annual earnings of more than $72,000, which is 62.2% higher than the national median income of $44,389 in 2004.[132] More than three fifths (62.9%) of payment option borrowers and nearly half (46.9%) of interest-only borrowers had monthly incomes above $6,000. In contrast, those earning around the median income and below were the least likely to receive non-traditional mortgages. About one in eight (12.3%) payment option borrowers and about one in six (15.6%) interest-only borrowers had monthly incomes below $4,000 (which at most is $48,000 annually, which is at most 8.1% above the national median income). About one fifth of interest-only and payment option borrowers (21.3% and 22.7% respectively) had monthly incomes between $4,000 and $6,000, or annual earnings between $48,000 and $72,000.



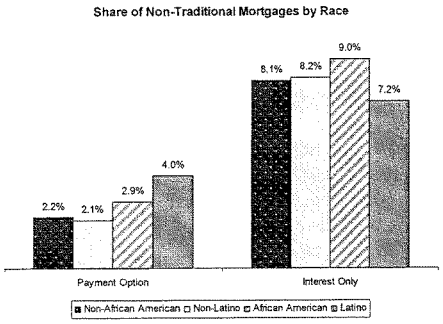
The incomes for borrowers of these non-traditional mortgage products are generally higher than those of mortgage products overall. There were 45.2% more non-traditional mortgage borrowers with monthly incomes above $6,000 than all mortgage borrowers. About half the non-traditional mortgage borrowers had monthly incomes above $6,000 compared to about a third (34.7%) of all borrowers. More borrowers in the middle income range received traditional mortgages than non-traditional mortgages. About half (54.8%) of all borrowers had monthly incomes between $2,000 and $6,000 compared to about one third (36.0%) of non-traditional borrowers. Lower-income borrowers are more likely to receive traditional mortgages than non-traditional mortgages. However, more than ten percent (11.9%) of borrowers earning between $24,000 and $48,000 annually received payment option mortgages and one in seven (15.0%) of these borrowers received interest-only mortgages.

[132] Census Bureau, "Income, Poverty, and Health Insurance Coverage in the United States: 2004," P60-229, August 2005 at 3.

Some non-traditional mortgage borrowers, especially interest-only borrowers, did not record their incomes, and these borrowers may be low-documentation or no-documentation borrowers. Interest-only borrowers were more than twice as likely to have invalid incomes (unknown or unreported incomes) as all borrowers. About one in fifteen (7.2%) of all borrowers had invalid incomes compared to about a sixth (16.1%) of interest-only borrowers. Only 2.1% of payment option borrowers had invalid incomes.

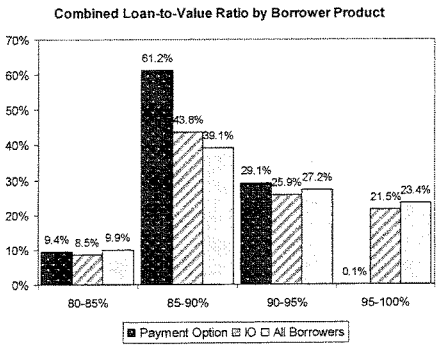
Distribution of Non-Traditional Mortgage Borrower Racial Characteristics

African American and Latino borrowers are more likely to receive payment option mortgages than non-African American or non-Latino borrowers and African Americans are more likely to receive interest-only mortgages than non-African American borrowers. Overall, Latinos are nearly twice as likely as non-Latinos to receive payment option mortgages. One in fifty (2.1%) non-Latino borrowers received payment option mortgages compared to the 4.0% of Latinos that received payment option mortgages. African Americans were 30.4% more likely than non-African Americans to receive payment option mortgages. 2.2% of non-African Americans received payment option mortgages compared to 2.9% of African Americans. African Americans were more likely than non-African Americans to receive interest-only loans and Latinos were less likely than non-Latinos to receive interest-only mortgages. Nearly one in ten (9.0%) of African Americans received interest-only mortgages, 11.7% higher than the 8.1% of non-African Americans that received interest-only mortgages. 7.2% of Latinos received interest-only mortgages compared to 8.1% of non-Latinos.



Distribution of Loan-to-Value Ratios

Generally, borrowers with non-traditional mortgages have lower debt loads than borrowers overall. Combined loan-to-value (CLTV) ratios measure the overall mortgage debt (including junior liens from piggyback mortgages) against the value of the property. More than half of non-traditional borrowers had loan-to-value ratios below 90 percent compared to more than half of all borrowers who had loan to value ratios above 90 percent. More than 70 percent (70.6%) of payment option

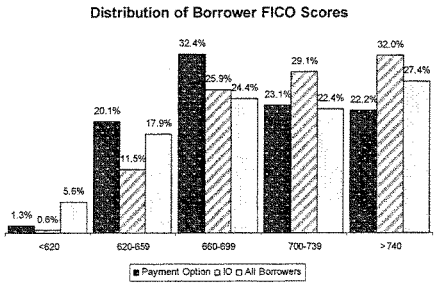


borrowers had loan-to-value ratios below 90 percent, compared to 52.3% of interest-only borrowers and 49.0% of all borrowers. Only two payment option borrowers (0.1%) had loan-to-value ratios over 95 percent. Interest-only borrowers are more likely to have higher loan-to-value ratios than payment option borrowers. More than one in five (21.5%) interest-only borrowers and nearly one in four (23.4%) of all borrowers had loan-to-value ratios over 95 percent. (Very few borrowers sampled had loan to value ratios above 100 percent (0.0% of borrowers overall and 0.1% of non-traditional borrowers) or below 80 percent (0.1% of all and non-traditional borrowers.)

Distribution of Creditworthiness

Lenders offer mortgage products and the pricing of these products based on credit-risk factors including credit scores, loan-to-value ratios, and consumer debt loads. Credit scores are an estimation of the borrower's risk assigned by the lending industry using proprietary criteria – such as repayment history, debt loads, the length of a borrower's credit history and other factors. The most common credit score is known as a FICO score, named for the Fair Isaac Company which compiles it.

Generally, payment option borrowers have lower credit scores than borrowers overall and interest-only borrowers have higher credit scores than borrowers overall. More than half (53.8%) of payment option borrowers had FICO credit scores below 700 compared to 48.2% of all borrowers and 38.6% of interest-only borrowers. In contrast, more than three fifths (61.1%) of interest-only borrowers had credit scores above 700, compared to just under half (49.8%) of all borrowers and 45.3% of payment option borrowers. This suggests that interest-only borrowers are better credit risks and payment option borrowers are worse credit risks than borrowers overall.



However, it is possible that credit scores may not adequately measure the risks of these newly prevalent loan products. Credit scores may be a good measurement of the likelihood of credit card debt repayment, but they *may* not adequately measure the likelihood of repayment for loan products where the debt payment abruptly increases, as both interest-only and payment option mortgages do. As the credit rating company Fitch Ratings noted, "Traditional FICO scores may not be as predictive of a borrower's ability to repay a loan as it was in the past, particularly with Option ARMS."[133]

CFA's analysis of this database represents a snapshot of some portion of non-traditional mortgage borrowers not necessarily representative of the overall non-traditional mortgage market. However, the data presented herein offer one of the first opportunities to examine characteristics of non-traditional mortgage borrowers. Although these borrowers broadly have

[133] Fitch Ratings, "U.S. Mortgage Products: Only Time Will Tell," September 22, 2005 at 3.

higher incomes and credit scores than borrowers overall, many of the borrowers had median incomes and middle credit scores. Borrowers with median household incomes of about $44,000 could face considerable financial hardships if the payment shock on their mortgage increases their monthly housing payment by a quarter or a half.

5. Key Concerns Over Non-Traditional Mortgages

Then-Federal Reserve Chairman Alan Greenspan this past summer received much publicity for trumpeting the potential dangers resulting from the increased reliance on non-traditional forms of mortgage financing:

> Apparent froth in housing markets appears to have interacted with evolving practices in mortgage markets. The increase in the prevalence of interest-only loans and the introduction of more exotic forms of adjustable-rate mortgages are developments of particular concern. To be sure, these financing vehicles have their appropriate uses. But some households may be employing these instruments to purchase homes that would otherwise be unaffordable, and consequently their use could be adding to pressures in the housing market. Moreover, these contracts may leave some mortgagors vulnerable to adverse events. It is important that lenders fully appreciate the risk that some households may have trouble meeting monthly payments as interest rates and the macroeconomic climate change.[134]

Other federal regulators, some industry analysts and consumer advocates also have questioned whether:

- Borrowers are using these mortgages for increasing their purchasing power, without adequately understanding their potential downside?
- Lenders are making loans to consumers for which they are not appropriate?
- The proliferation of these mortgage products is contributing to affordability problems and a housing bubble?
- These mortgage products pose a growing threat to credit quality, thus raising concerns about their sustainability for consumers?

Many non-traditional mortgage borrowers may not fully understand the long-term monthly payment burden and may face significant payment shocks when their loans are recast to higher payment schedules. Adjustable rate mortgages can be tempting to borrowers because of their lower interest rates and especially their lower initial rates or short-term teaser rates. Borrowers receive these low opening rates to encourage them to take on the additional interest rate risk that can make the loans become more expensive over the term of the mortgage. Consumers may not fully appreciate that the initial rate will snap sharply upwards when the loan first adjusts, may not understand that the teaser rates – especially for the super-low rates some option ARMs have offered for a few months – are not the starting ARM rate, and some borrowers may not realize

[134] Greenspan, Alan, Federal Reserve's Semiannual Monetary Policy Report to Congress. Testimony Before the Committee on Financial Services, U.S. House of Representatives, July 20, 2005.

the extent to which their monthly mortgage payments could continue to rise over the course of the mortgage.

In 2004, the Federal Trade Commission filed an injunction against a mortgage broker and lender in Nevada for advertising negatively amortizing option ARM payments as "low fixed payments" without clearly stating that the interest rates were not fixed and that the lowest payments were not "savings" to the borrower since they increased the borrower's debt.[135] In 2005, a borrower filed suit against Chevy Chase Bank after the initial teaser rate elapsed and the interest rate more than doubled from 1.95% to 4.375% two months after the loan was closed because the family believed the teaser rate was for the entirety of the period before the loan adjusted its interest rate.[136]

The higher risk to borrowers and the complexity of the loan terms and repayment schedules of most non-traditional mortgages make it all the more imperative that borrowers receive the information they require from loan providers so that they can make adequately informed choices. The Comptroller of the Currency has stated that "Disclosures should clearly and reasonably describe the significant potential consequences of the particular product, which in this case would mean the potential payment shock."[137] Chief Counsel of the Comptroller, Julie Williams, noted that there are questions and concerns "about the marketing and disclosure practices spawned by the new practices and whether consumers fully understand the products they are selecting."[138] The agency has also warned lenders about the prospects of increased litigation risk.

There seems to be general agreement that ensuring that consumers are adequately informed about the risks as well as the benefits of non-traditional markets is essential. Indeed, a recent Radian Guaranty survey found that while homeowners stressed the importance of understanding how much home they can afford when looking for financing, less than one-half (48%) believe they were knowledgeable about the mortgage options available to them.[139]

A past CFA survey found that when consumers were asked to calculate the change in payments resulting from different interest rate increases, a third of consumers could not estimate the increase, while the remainder as a group underestimated payment impact by about 30 percent. Moreover, the survey found that more lower income, younger, and minority respondents could not estimate the payment increases or underestimated them than of all consumers surveyed.[140]

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[135] *See* Federal Trade Commission v. Chase Financial Funding et al, Case No. SACV04-549 GLT, U.S. District Court, Central District of California, May 11, 2004.
[136] Simon, Ruth, "A Trendy Mortgage Falls from Favor," November 29, 2005.
[137] Remarks by John C. Dugan, Comptroller of the Currency, Before the OCC Credit Risk Conference, Atlanta, October 27, 2005 at 9.
[138] Remarks by Julie L. Williams, Chief Counsel and First Senior Deputy Comptroller, Office of the Comptroller of the Currency, Remarks Before the Canisius College School of Business, Buffalo, September 14, 2005 at 3.
[139] Radian, "U.S. Homeowners Can (and Should) Learn More About Their Mortgages," press release, November 21, 2005.
[140] Consumer Federation of America, "Lower-Income and Minority Consumers More Likely to Prefer and Underestimate the Risks of Adjustable Rate Mortgages," press release, July 26, 2004.

Non-Traditional Mortgages Contribute to Affordability Problems and the Housing Bubble

The presence of non-traditional mortgage products has facilitated an escalating cycle of rising home prices. Although non-traditional mortgages are marketed in part as an affordability tool for borrowers to become homeowners despite record-high housing prices, the ability of borrowers to leverage their purchasing dollars with non-traditional mortgages contributes to the rising housing costs. Buyers with non-traditional mortgages can either purchase larger homes than they might be able to afford with a fixed rate mortgage or bid up the home prices. As these buyers put upward pressure on the price of their home purchases, other home sellers increase their asking price and even more borrowers need non-traditional mortgages in order to afford their home purchases. *USA Today* editorialized at the end of 2005 that "When exotic loans become routine, the economics of housing becomes anything but. These loans add something new and troubling. One might call it a bubble."[141]

Essentially, wider access to credit, including non-traditional mortgages creates an arms race between the credit and real estate industry. Rising prices stimulate the demand for more credit mortgages which increase demand for higher-priced homes. As San Francisco Federal Reserve Senior Economist noted:

> Rapidly rising stock and house prices, fueled by an accommodative environment of low interest rates and a proliferation of "exotic" mortgage products (loans with little or no down payment, minimal documentation of income, and payments for interest-only or less) have sustained a boom in household spending and provided collateral for record-setting levels of household debt relative to income.[142]

It is unquestionable that the housing and real estate market has been extremely strong over the past decade. Between 1997 and 2005, home sale prices nationally rose by 55 percent after adjusting for inflation and these increases have added $6.5 trillion in household wealth.[143] In 2005, the number of home sales hit a fifth consecutive record year and home price appreciation was steady across the country, with many metropolitan areas having annual price increases above 10 percent.[144] Silver Spring, Maryland-based mortgage trainer Christopher Cruise noted that "These types of products have been enablers when it comes to allowing home prices to rise."[145]

Some warn that the stratospheric growth in the housing market could slow if there is less access to non-traditional mortgages. The converse of non-traditional mortgage availability's contribution to the housing bubble is that if access to this credit is tightened, the rise in housing prices may slow or even reverse.[146] Regardless of the cause, the homeowners who will be most

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[141] Editorial, "As Risky Home Loans Rise, House-Price 'Bubble' Inflates," *USA Today*, December 28, 2005.
[142] Lansing, Kevin J., "Spendthrift Nation," *FRBSF Economic Letter*, Federal Reserve Board of San Francisco, No. 2005-30, November 10, 2005.
[143] Baker, Dean and David Rosnick, "Will a Bursting Bubble Trouble Bernanke? The Evidence for a Housing Bubble," Center for Economic and Policy Research, November 2005 at 3.
[144] National Association of Realtors Research Division, "The 2005 National Association of Realtors Profile of Real Estate Markets: The United States of America," December 2005 at 2.
[145] Downey, Kirsten, "Regulators to Issue Mortgage Warning," *Washington Post*, April 7, 2006.
[146] Pasha, Shaheen, "Risky Home Loan Standards Tightening," *CNN/Money*, January 6, 2006.

severely hurt by any downturn in the housing market are the non-traditional borrowers who have purchased the most recently with the least equity in their homes.

6. What Actions are Needed to Protect Borrowers and Lenders

With the continuing proliferation of non-traditional mortgage products over the past two years, it should not come as any surprise that federal regulators would be weighing new oversight policies. There also has been the suggestion that action is needed to plug any "regulatory gap" in consumer protections for these products. Very possibly Congress also may venture into this topic and consider whether new legislation is needed.

New Federal Guidance on Non-Traditional Mortgage Products

After months of anticipation, federal banking agencies this past December issued proposed new regulatory guidance for lenders on non-traditional mortgage products.[147] In issuing the guidance, the regulators said in a joint statement:

> (We are) concerned that these products and practices are being offered to a wider spectrum of borrowers, including subprime borrowers and others who may not otherwise qualify for more traditional mortgage loans or who may not fully understand the associated risks.

The guidance directed banks to tighten their lending practices for non-traditional mortgage products and focused in particular on interest-only mortgages and payment option ARMs. The directive also noted that lenders are increasingly combining these types of products with other high risk practices, such as simultaneous second-lien mortgages and the use of reduced documentation in qualifying home loan borrowers.

The guidance addresses three areas: loan terms and underwriting standards, portfolio and risk management practices, and consumer protection.

Loan Terms and Underwriting Standards: The guidance advises lenders that they should take into account the borrower's debt "repayment capacity" over the life of the mortgage. Interest-only mortgage loan borrowers must qualify at the fully amortizing payment corresponding to the fully indexed rate at reset: In other words, the borrower's monthly payment after the introductory teaser rate has expired. Teaser rates with potential for extraordinary payment shock should be avoided altogether. Qualifications for payment option mortgages must consider potential negative amortization assuming minimum monthly payments. Risk layering should be compensated by mitigating factors such as high FICO scores, low debt-to-income and reduced loan-to-value and used cautiously for subprime borrowers.

Portfolio and Risk Management Practices: The guidance also sets out a range of safety and soundness practices that lenders offering non-traditional mortgage products should be using. These include the setting of acceptable risk levels that include concentration limits for payment

[147] *See*, Interagency Guidance on Nontraditional Mortgage Products, 70 Federal Register, 77249, December 29, 2005.

option loans, geographic areas, low FICO scores, high consolidated loan to value ratios, and high debt to income ratios. It also stresses that lenders making these loans should have in place stronger controls and enhanced information and reporting and should closely monitor the third-party origination channels (i.e., mortgage brokers and correspondent lenders) that emphasize the marketing and disclosure practices that are used.

Consumer Protection: The guidance states that federal regulators "are concerned that consumers may enter into these transactions (non-traditional mortgages) without fully understanding the product terms."[148] They appear to frown on lending practices that promote non-traditional products advertised and marketed based on their initial monthly payment affordability, and that consumers have been encouraged to choose these loans based on the lower monthly payments these loans permit compared with traditional mortgage products. The guidelines emphasize that lenders should communicate with consumers in a manner that enables them to make informed decisions about these products. Such information should include clear descriptions about the pitfalls of non-traditional products when consumers are shopping for mortgages and before they submit loan applications.

The guidance proposes a series of "recommended practices" for how this communication should occur. For example, promotional materials should be balanced and fully explain all the risks, including the payment shock that could occur when the product re-prices as well as the dangers of negative amortization, provide alerts about prepayment penalties and the amount of any such penalty, and also inform about pricing premiums attached to reduced documentation loans. Monthly payment statements on payment option ARMs should provide explanations of the impact that making a minimum payment will have on loan balances due to negative amortization.

Potential Effects of the New Guidance:

The guidance's issuance should not have come as a shock for lenders. For months prior to issuance, regulators had sounded warnings about the need for lenders to tighten up on their underwriting standards for these loans. The 41 page guidance was published in the Federal Register in late December and issued for a sixty day public comment period. This period was extended for an additional 30 days in response to requests from lenders (March 29, 2006).

The impact and reach of the guidance is a subject of considerable discussion. Its issuance seemed to have had an immediate effect on some lender practices.[149] A number of large lenders have stressed that they already employ the types of standards encouraged by the guidance. Yet, since the guidelines neither propose new rules nor apply many specific standards, their impact more likely will be determined by how they are interpreted. Some analysts recall that lenders all but

[148] Interagency Guidance on Nontraditional Mortgage Products, 70 Federal Register, 77249, December 29, 2005 at 77255.
[149] "WAMU Again Tightens its Option ARM Standards, Negative Amortization Loans 'in all Channels' Affected by the Change," *American Banker*, January 27, 2005.

ignored another guidance issued earlier in 2005 about equity loans and actually increased the level of lending on those loans.[150]

Moreover, since the guidance applies only to regulated depository institutions (banks and thrifts) and their subsidiaries, and not to their non-bank lending affiliates, the reach it will have on these and other important segments of the non-traditional mortgage market is uncertain.

New Loan Disclosure Requirements?

Another limitation is that, notwithstanding the fact that the guidance discusses the need for improved disclosures to consumers, the guidance does not expand any consumer protections, nor will consumers be able to enforce the application of these standards to individual lenders. What the guidance does instead is to advise lenders to inform consumers of the potential for payment shocks, to state maximum monthly payments and describe the timing of payment changes down the road.

Even if more comprehensive disclosures were to be required, this additional information still may be insufficient given the complexity and wide array of products commonly featured today. While loan disclosures provide standardized information they also can serve to shield lenders from accountability for not fully informing borrowers about key loan features.

The Truth in Lending Act (TILA) and its implementing rules, Regulation Z, govern the types of disclosures lenders must provide to consumers for closed-end mortgages in advertisements, with an application, before loan consummation, and when interest rates change. Certain special disclosures apply to ARM products and must be provided at the time an application is provided or before the consumer pays a non-refundable fee, whichever is earlier.

Regulation Z mandates that loan disclosures for variable rate loans occur at three stages. First, when the consumers initially seek out a lender regarding an ARM they must be provided with the "Consumer Handbook on Adjustable Rate Mortgages," which was developed by the federal regulatory agencies. The brochure provides useful but general information about ARMs and how they work. Unfortunately, the checklist featured in the brochure provides for comparisons of only two adjustable rate products, which is no longer adequate considering the wide array of products available in today's marketplace.

The second disclosure is required to be provided to borrowers with the loan application form. Lenders are required to list various items for each variable rate program in which the consumer has expressed an interest. No precise format is provided under current federal rules and therefore, the quality of the information provided by lenders can and does vary considerably. Moreover, while this disclosure may provide information about an ARM similar to the one the borrower is considering, it need not provide details about the very same loan being offered. The third type of disclosure seeks to quantify the risks inherent in an ARM, either by providing historical or worst case examples of how payments can increase. However, lenders again need not provide this information for the specific loan the borrower is set to receive. Jack Guttentag,

[150] Perkins, Broderick, "Feds Release Promised Proposed Risky-Loan Guidelines," *Realty Times*, December 26, 2005.

the noted mortgage lending expert, describes the current state of ARM disclosures this way: "The sad conclusion is that the mandated disclosures try to do too much and end up accomplishing little or nothing."[151]

Supplementing Consumer Loan Disclosures

Even if more comprehensive disclosures were required to be made to consumers regarding non-traditional mortgages, this still may not be sufficient given the complexity and wide array of products available today. The experience with the disclosures in place suggest that virtually any form of information provided may not be adequate to provide less financially sophisticated borrowers with the information they need to make wise choices. Further, even those that think they understand the risks may not understand the potential long-term consequences of certain non-traditional products being mass marketed. Some borrowers elect to take out riskier mortgages to qualify for home purchase, believing that they can always sell their property or refinance the mortgage should payment shock occur. However, should the real estate market soften and prices decline, these borrowers could find themselves in "upside down" loans, with balances exceeding the value of their homes. Thus, for these circumstances, selling or refinancing would not be a viable strategy for avoiding significantly higher payments.

Key features in the guidance, such as the borrower repayment analysis, would seem to recognize that even increased information and disclosures to borrowers are insufficient. Through the adoption of new understanding standards, the regulators seem to be putting lenders on notice about their responsibility to develop appropriate loan standards that neither encourage nor accept applications from borrowers who clearly cannot afford dramatically increased payments. Thus, the guidance may also have the effect of further fueling a discussion on the need for suitability rules that protect borrowers from receiving inappropriate loan products from lenders. Suitability standards have been used by the securities and insurance industries, and it is not unimaginable that these types of requirements could be adapted to the mortgage lending field.

Consumer advocates are concerned about the consequences of mass marketing non-traditional products for vulnerable borrowers, particularly those that rely on higher-cost subprime financing to purchase homes and refinance their properties. Evidence suggests that this borrower group is particularly susceptible to victimization from abusive and predatory lending practices. A majority of subprime ARMs are due to reset in the next two years and rising interest rates could make these loans unaffordable to refinance for some portion of these borrowers. Federal law and many state laws provide some protections for some of these borrowers, but it may not be enough to protect them from being preyed upon by predatory lenders. Consequently, public policy discussions on these topics must include consideration of the types of protections that would be most useful for borrowers with less than prime credit.

In sum, CFA believes that more can be done to ensure that consumers are fully aware of the financial risks of complex and potential risky mortgage products they choose. At a minimum, consumers need to fully and adequately understand how non-traditional mortgages work and be provided with timely, clearly worded and balanced information about how the terms of the specific mortgages they choose and impact these terms impact on their household finances over

[151] Jack Guttentag at Mortgage Professor, www.mtgprofessor.com.

the lifetime of the mortgage. However, this may not be enough. The plain fact is that deferred payment mortgage products simply may not be appropriate for all borrowers who receive them and therefore, a threat to homeownership sustainability.

CFA believes that that the mortgage industry, consumer and housing organizations, and government all have a common stake in helping consumers to make wise choices in the financing products they choose. The actions taken by these parties in the months ahead will determine much about whether non-traditional mortgage products are viewed by the public as merely exotic and not toxic.

TESTIMONY SUBMITTED BY THE:

CONSUMER MORTGAGE COALITION

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

UNITED STATES HOUSE OF REPRESENTATIVES

"Home Mortgage Disclosure Act: Newly Collected Data and What It Means"

June 13, 2006

The Consumer Mortgage Coalition ("CMC"), a trade association of national residential mortgage lenders, servicers, and service providers, appreciates the opportunity to submit its written testimony to the House Financial Services Subcommittee on Financial Institutions and Consumer Credit concerning the implications of the 2005 data submitted under the Home Mortgage Disclosure Act ("HMDA"). Our testimony will first discuss the meaning of the HMDA results and then suggest an approach to improving the outcome for minorities, using a market-based approach rather than new restrictions on lenders that are likely to reduce the supply and increase the cost of mortgage credit for minority borrowers.

In order to assist the Committee in its deliberations on this important issue, attached to our testimony is an analysis prepared by the CMC's outside counsel, Buckley Kolar, LLP entitled "The Home Mortgage Disclosure Act: Its History, Evolution, and Limitations."

Finally, ongoing information on HMDA can be found at www.hmdainfo.com, a website the CMC maintains in order to keep interested parties informed.

Meaning of the HMDA Data

In considering the results of the 2005 HMDA data, we emphasize the following key points:

- ***Studies that draw conclusions from HMDA and other loan data should be viewed cautiously and should be subjected to a peer-review process before their results are used as the basis for setting policy.*** A good example of the importance of careful review and analysis by experts is the expected increase in the proportion of loans whose prices are reportable under HMDA between 2005 and 2004. The federal regulators have recognized that this difference does *not* result from changes in lender practices but to changes in the interest-rate environment between the two years.[1]

- ***The data used as the basis for studies by advocacy groups purporting to show pricing discrimination should be made available to academic experts in a peer-review process.*** As Federal Reserve Chairman Bernanke has stated, "the data never 'speak for themselves,' and the HMDA information, like any data set, must be interpreted with care and insight."[2] Although the reports issued by advocacy groups claim large discrepancies in the number of minorities who were offered loans that exceed the reporting threshold, as compared to non-minorities, the relevant question should not be whether more minority loans happened to exceed a regulatory threshold – which, as noted, can vary from year-to-year for other reasons – but whether minorities are paying more than similarly-situated non-minorities for the same

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1 *See* Federal Reserve Board, Federal Deposit Insurance Corporation, Department of Housing and Urban Development, Office of the Comptroller of the Currency, Office of Thrift Supervision, and National Credit Union Administration, "Frequently Asked Questions About the New HMDA Data, " (Apr. 3, 2006), *available at* http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20060403/default.htm.

2 Remarks by FRB Chairman Ben S. Bernanke at the Greenlining Institute's Thirteenth Annual Economic Development Summit, Los Angeles, Calif. (Apr. 20, 2006), *available at* http://www.federalreserve.gov/boarddocs/Speeches/2006/20060420/default.htm.

product. Another oft-cited reason that the studies from advocacy groups require additional scrutiny is the fact that they typically use a "single-lender" model that presumes, in essence, that all lenders use the same underwriting and credit granting guidelines. Because that underlying assumption is faulty, these studies end up at variance with the detailed analyses that take into account individual lender differences, including both the studies performed by the lenders themselves and those performed by the federal banking regulators in their examinations and investigations.

- ***Based on the 2004 HMDA data, the Federal Reserve Board ("FRB") identified approximately 200 lending institutions as potentially having problematic disparities.*** These lenders have been asked by their federal fair lending regulator to explain in detail why these disparities exist and to show that the disparities do not result from discrimination. These examinations and investigations are being conducted with great care on an institution-by-institution basis, with the ability to understand precisely how a particular lender does business, and whether the lender's business operations illegally discriminated against minority borrowers. Where the regulator believes that discrimination actually exists, it will refer the lender to the Department of Justice for further enforcement action. Even where discrimination is not found, affected lenders are likely to modify their practices to reduce the risk of incurring the costs of another fair lending investigation. We expect that the FRB will analyze the 2005 HMDA dataset in the same way to identify lending institutions that it believes require further scrutiny, and that the federal bank regulators and the other federal fair lending enforcement agencies will continue to vigorously pursue discrimination cases.

- ***Although we believe that the evidence, on review, will indicate that disparate results are not related to discrimination or abusive practices, there are many steps that should be taken to improve the experience of minorities in obtaining mortgage credit.*** Even when the HMDA data do not reveal discrimination or other illegal practices, they may suggest ways to reduce the disparities. As discussed below, CMC supports a market-based approach that would address this issue by improving competition and the flow of information to all borrowers, particularly minorities. Our approach would also address consumer education, a factor that would help minority and disadvantaged consumers manage their finances in a way that indicates high credit quality to lenders.

- ***Industry data show that subprime pricing "spreads" have been severely narrowing and each month brings additional news of substantially reduced profits at subprime lending institutions.*** What this means is that competition is working to bring lower pricing to consumers with blemished credit histories or who otherwise desire a non-traditional product. Smart regulation of this market will seek to encourage, rather than discourage, new entrants into this market.

CMC's Market-Based Approach to Improving the Mortgage Market

Some have suggested further restrictions on the practices of lenders, including a ban on any discretionary pricing and new "suitability" requirements. We believe that these proposals, if implemented, would be counterproductive because they would lead to higher prices and reduced availability of credit. CMC proposes, instead, a set of market-based solutions to ensure fair and equitable lending. These proposals would improve disclosures, increase competition for settlement costs, promote the use of alternative underwriting systems, and educate and inform consumers to select appropriate loans and avoid unlicensed or unethical loan originators. In short, we should empower consumers to use the market and let market competition serve consumers.

These solutions are summarized as follows:

- **Mortgage Reform.** The Real Estate Settlement Procedures Act ("RESPA") should be reformed to simplify and guarantee shopping disclosures in a manner that enables and encourages more borrowers, particularly those with blemished credit, to shop for and compare alternative loan products. At the same time, the regulatory barriers in RESPA, which currently prevent competition from reducing costs, should be eliminated. Other mortgage reforms proposed by CMC would protect against loan-flipping, restrict prepayment penalties, enable borrowers facing foreclosure to realize the equity in their homes, and improve collection practices. Current regulatory requirements do not allow consumers to understand their choices, but, on the contrary, often act as barriers to competition that could reduce costs. Studies have shown that the innumerable disclosures required by a variety of federal and state laws often confuse, and sometimes mislead, consumers who are attempting to shop for loans. Moreover, given the very high percentage of loans originated through mortgage brokers, and given the mortgage brokers' advocacy that mortgage brokers are in essence the same as other mortgage originators such as lenders, it is crucial that consumers receive appropriate disclosures of the broker's relationship with the consumer.

- **Competitive Underwriting Systems.** Public policy should promote the use of competitive automated underwriting systems that will provide the greatest opportunities for borrowers with imperfect credit to obtain the lowest-cost loan. While we advocate increased competition for the costs and terms of loans, we also need greater competition in the underwriting systems that are used to underwrite the vast majority of mortgage loans in this country, which will lead to greater choices. Two automated underwriting systems ("AUS") – Freddie Mac's Loan Prospector and Fannie Mae's Desktop Underwriter – currently dominate the market, which has raised concerns about whether the GSEs are limiting access to the mortgage market for many borrowers. These AUS are perceived to allow loan originators less flexibility in considering compensating factors or alternative credit history (*e.g.,* utility bills or rental payments) that would permit disadvantaged borrowers to qualify for conforming loans. While the GSEs are said to be addressing some of these issues, multiple underwriting systems that provide alternative and more flexible standards are better for consumers than being subject to just two dominant systems. More

competition would provide more choices.

- **Public Awareness, Education, and Counseling.** A widespread public awareness and education campaign should be instituted. The program should include providing government-sanctioned software and other tools to help consumers understand the loan process and to compare loans. In addition, the consumer education program should make financial and loan counseling widely available to potential borrowers to help them make prudent loan decisions.

- **Nationwide Licensing Registry and Net Worth Requirements.** All mortgage brokers should be licensed, and the licensing violations of all mortgage originators should be publicly available in a registry. This would allow borrowers to investigate their use of a broker or lender and be forewarned when dealing with one who has committed violations. It would also allow lenders to avoid dealing with brokers (or to avoid hiring individuals as a loan origination employee) who have been subject to sanctions by state regulators.

  In addition, mortgage brokers should be subject to appropriate net worth requirements to ensure that mortgage brokers have sufficient financial resources to support their obligations.

- **Uniform National Rules.** To the extent federal legislation is pursued, it should provide nationwide uniform rules that reflect the national character of the residential mortgage market.

- **Enforcement of Existing Laws.** Adequate resources at both the federal and state levels of government must be devoted to pursuing those committing violations of existing law such as discrimination or fraud.

Fair Lending Commitment

Reflecting our commitment to fair lending, CMC members have also taken concrete steps to ensure that all applicants are able to experience the mortgage loan process without concern for illegal discrimination, including:

- Establishing clear policies at the highest levels of management requiring compliance with all fair lending obligations and refusing to tolerate any form of illegal discrimination in their lending or business practices by any of their officers, employees, or agents in serving their customers and potential customers;

- Implementing clear procedures to ensure all officers, employees, and agents comply with company policies regarding fair lending;

- Training their loan originators, call center operators, processors, underwriters, customer representatives and others with involvement in the consumer's loan process on the requirements of fair lending, and the importance of treating all applicants

consistently, and with courtesy and respect;

- Communicating their fair lending policies to their agents, mortgage brokers, contractors and vendors who are involved in the loan process, including appraisers and closing agents;

- Ensuring marketing communications and materials reflect an inclusive potential customer audience and comply with all requirements for the Equal Housing Lender poster and logo;

- Making available information, guides, and easy-to-use tools to help prospective borrowers understand the mortgage process, the important terms of the loan, key disclosures, and calculators to help them shop for an affordable loan;

- Pricing loan products based on appropriate credit and risk-related criteria, without regard to race, national origin, or other prohibited factors;

- Monitoring call center operators and auditing loan files, to ensure consistent treatment of all applicants and borrowers;

- Establishing and maintaining systems and procedures to receive, analyze and quickly respond to any complaints regarding any alleged or potential discriminatory treatment;

- Ensuring consistent treatment of borrowers in all loan servicing activities;

- Making available tools and financial resources to increase financial literacy and credit awareness among the general population, to help inform the public of how credit scores can impact a person's ability to obtain mortgage credit, and how to enhance creditworthiness, and supporting community efforts to do the same;

- Creating and maintaining work environments that emphasize respect for all persons and promoting diverse workforces that will continue to reflect the values, aspirations, and spirit of our multi-cultural communities; and

- Working with community groups and national consumer organizations to develop outreach programs to make credit opportunities available to under-served segments of our society.

CMC members have pledged to continue these efforts and to expand them to ensure that no person seeking a mortgage loan in this country feels the sting of illegal discrimination, and to promote greater participation by all in the substantial benefits that flow from home ownership.

Conclusion

The CMC appreciates the opportunity to submit its views on the meaning and implications of the new HMDA data. We look forward to working with the Committee on constructive, practical solutions to address any remaining disparities based on minority status and to improve the mortgage experience for all borrowers.

* * *

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The Home Mortgage Disclosure Act: Its History, Evolution, and Limitations†

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February 2006

This article analyzes the history and effects of the Home Mortgage Disclosure Act ("HMDA").[3] It focuses on the general purposes of HMDA and the evolution and expansion of those purposes over time. Finally, it discusses the limitations of the HMDA data in determining whether discrimination has occurred.

I. History of HMDA

The history of HMDA since it was enacted in 1975 can be divided into three major phases, reflecting the dramatic changes in the mortgage industry that have occurred since enactment, as well as changes in perception by the industry's critics in the advocacy community and on Capitol Hill regarding how the industry serves low-income communities and members of minority groups.

- **Depository institution community reinvestment/disinvestment model.** From enactment until the late 1980s, HMDA reporting focused on originations by depository institutions in urban areas. This reflected the perception that banks and thrifts were taking deposits from lower-income neighborhoods but not "reinvesting" that money in the form of loans to the same neighborhoods. No application data were collected, and HMDA reporting did not include racial or ethnic data about particular borrowers. Institutions reported aggregate statistics about the dollar amounts and specific locations of their residential loans but did not have to disclose their lending on a loan-by-loan basis. HMDA data were expected to assist regulators in identifying institutions that were failing to lend money in communities in which they were taking

† A version of this article previously appeared in 59 *Consumer Finance Law Quarterly Report* 189 (Fall 2005). Reprinted with permission.

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3 Home Mortgage Disclosure Act of 1975, Pub. L. 94-200, tit. III, 89 Stat. 1125 (12 U.S.C. §§ 2801-2810) (Dec. 31, 1975).

deposits and to help local officials identify neighborhoods that were not receiving sufficient capital to stem urban decay.

- **Mortgage lender discrimination model.** Starting in the late 1970s, mortgage lending began to migrate from traditional depository institutions that hold loans in portfolio to non-bank mortgage bankers (including affiliates of banks and thrifts), often operating on a regional or nationwide basis, that would sell loans into the secondary market. The model of a mortgage market provided by community banks that make local mortgage loans funded by local deposits began to fade (although it still has not entirely disappeared), as did the notion that lenders were engaging in wholesale redlining of neighborhoods, as opposed to more subtle forms of discrimination. By the mid- to late-1980s, advocates and government regulators had begun turning their attention to the lending practices of the new types of mortgage lenders. The focus changed from "disinvestment" in certain neighborhoods to discrimination in underwriting. As a result of legislative changes in the late 1980s, HMDA reporting was vastly expanded to include data about most bank and non-bank lenders in urban areas. The data now included racial, ethnic, and gender information, as well as income for each applicant, and reflected both rejected and accepted applications for loans that did not close. In implementing the legislative changes, the Federal Reserve Board ("FRB" or "Board") decided to require public disclosure of each application and closed loan, with identifying information redacted.

  While the expanded HMDA data showed that most institutions accepted the vast majority of applications from any group, they also showed a disparity in the acceptance rates between groups, and in particular, higher acceptance rates for whites than either African-Americans or Hispanics. Some community advocates immediately equated these disparities with discrimination, although the HMDA data still omitted much of the information considered in mortgage underwriting, including such critical factors as the applicant's credit history and current debt load. The Federal Reserve Bank of Boston conducted a study (the "Boston Fed Study") that augmented the HMDA data with other underwriting information. The conclusion of that study was that there was a smaller but still real disparity between white and minority rejection rates even after controlling for legitimate underwriting factors. Both scholars and the lending industry vigorously disputed that finding, criticizing both the design and the execution of the Boston Fed Study. At the same time, lenders responded to the findings by making their underwriting criteria more flexible and convincing the largest government-sponsored enterprises ("GSEs"), Fannie Mae and Freddie Mac, to do the same. Lenders also created new products that were tailored to lower-income borrowers and increased their outreach efforts. Bank regulators began to use HMDA data, especially denial-disparity ratios, to identify institutions on which they would focus fair lending examination efforts. These efforts led to several Department of Justice ("DOJ") investigations and enforcement actions. Community activists used analyses of individual institutions' HMDA data in attempts to stall bank mergers, bring negative publicity to those institutions, or obtain lending or funding commitments from the institutions.

- **Predatory lending/price discrimination model.** One result of lenders' efforts to respond to the expanded HMDA reporting and the studies growing out of it was that fewer applicants were rejected outright for credit. Instead, with a growing range of products and terms available, many more borrowers were offered loans. At the same time, nonprime lending in general was growing rapidly and a secondary market for nonprime loans developed. Although these changes gave many more people access to financing to purchase and maintain their homes, the growth of this market was accompanied by complaints from community advocates of "predatory lending." In addition, with fewer applicants being rejected, the HMDA data about accepted and rejected loans were becoming less meaningful, and advocates claimed that lenders were offering credit to minorities and lower-income communities but on less favorable terms. In response, the FRB amended HMDA's implementing Regulation C to require reporting of pricing and Home Ownership and Equity Protection Act ("HOEPA") status on loans above a given price threshold. In an effort to improve the quality of HMDA data, the revised regulation also tightened the definitions of different types of loans and required the collection of racial and ethnic monitoring information in telephone applications.

HMDA Today: Current Requirements

Before recounting the history of HMDA, it is useful to summarize what the law currently requires. HMDA is implemented by the FRB in Regulation C.[4] HMDA's main features include the following:

- **Coverage.** HMDA has two categories of coverage: depository institutions (banks, credit unions, and savings associations) and other mortgage lenders. A depository institution is covered if it:

  - Had assets of more than $34 million on the preceding December 31;

  - Had a home or branch office in a metropolitan area[5] on the preceding December 31;

  - In the preceding calendar year, originated at least one home purchase loan or refinancing of a home purchase loan secured by a first lien on a one-to-four-family dwelling; and

  - Either is federally insured or regulated, or originated a home purchase loan or refinancing that was insured, guaranteed, or supplemented by a federal agency.

  A mortgage lender other than a depository institution is covered if:
  - It is a for-profit lender;

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[4] 12 C.F.R. pt. 203.

[5] HMDA has always required reporting of lending in metropolitan areas, although the terminology used to describe those areas has changed over time. The current terminology is "metropolitan statistical area or metropolitan division." This article will refer to areas subject to HMDA reporting as "metropolitan areas."

- In the preceding calendar year, its home-purchase loan originations (including refinancings of home-purchase loans), measured in dollars, were either 10% or more of its total loan originations or $25 million or more;
- It had a home or branch office in a metropolitan area on the preceding December 31, or received applications for, originated, or purchased five or more home-purchase (including refinancings) or home-improvement loans on property located in a metropolitan area in the preceding calendar year; and
- It had assets (including the assets of any parent corporation) of more than $10 million on the preceding December 31, or originated 100 or more home purchase loans (including refinancings of home purchase loans) in the preceding calendar year.

- **Data reporting.** Covered lenders must compile data in a Loan/Application Register ("LAR") about applications for, originations of, and purchases of home-purchase loans, home-improvement loans, and refinancings of home-purchase loans. They may also report home-equity lines of credit opened wholly or partly for home-improvement or home-purchase purposes. The following information must be collected for each application or loan:[6]
  - An identification number for the application or loan.
  - The date the application was received.
  - The type of loan (conventional, government-guaranteed, or government-insured). Government loans are identified by the insuring or guaranteeing agency.
  - The property type (1-4 family dwelling [including condominiums and co-ops], manufactured housing, or multifamily dwelling).
  - The purpose of the loan (home purchase, home improvement, or refinancing).
  - Occupancy (whether a 1-4 family dwelling, including a manufactured home, is the borrower's principal dwelling). This information is optional for multifamily dwellings and for those located outside metropolitan areas or in metropolitan areas where the lender does not have a home or branch offices. On a purchased loan, the lender can assume that the property is owner-occupied unless the application or loan documents indicate otherwise.
  - The loan amount, in thousands of dollars. For purchased loans, this field is the balance at time of purchase.
  - Whether the loan was initiated as a "preapproval request," defined as a request for a written, time-limited commitment to make a loan that is subject only to finding

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6 *See* 12 C.F.R. pt. 203 app. A.

an acceptable property and typical closing conditions. This field does not apply to purchased loans.

- The action taken on the loan (loan originated, application approved by the lender but not accepted by consumer [*i.e.*, withdrawn after approval by lender], application denied, application withdrawn, file closed for incompleteness, preapproval request denied, or preapproval request approved but not accepted [reporting approved but not accepted preapproval requests is optional]). Purchased loans are simply reported as loans purchased by the institution.

- The date the action was taken.

- The location of the property, including identification of the metropolitan area, the state and county, and the census tract. The census tract may be omitted if the property is located in a county with a population of 30,000 or less as of the 2000 census. Location information may be omitted entirely if the property is located outside a metropolitan area in which the lender has a home or branch office, or outside any metropolitan area, unless the lender is required to report under the Community Reinvestment Act ("CRA"). It may also be omitted if a preapproval request was denied, or approved but not accepted by the applicant.

- Race (American Indian or Alaska Native, Asian, Black or African American, Native Hawaiian or Other Pacific Islander, or White), ethnicity (Hispanic or not Hispanic), and sex of the applicant and co-applicant (if any), for both loans that were originated and loan applications that did not result in an origination. Reporting this information is optional for purchased loans.

- Applicant's income in thousands of dollars (defined as the income that the institution relied on in making its credit decision).

- The type of purchaser. This field applies only to loans sold into the secondary market in the same calendar year that they were originated or purchased. Lenders must report the type of purchaser, such as Fannie Mae; Freddie Mac; Ginnie Mae; a private securitization; a commercial bank or thrift; an insurance company, credit union, mortgage bank, or finance company; or an affiliated institution.

- Up to three reasons for denial. This is an optional field, except that institutions that are supervised by the Office of Thrift Supervision ("OTS") or Office of the Comptroller of the Currency ("OCC") must include it under those agencies' regulations.[7]

- Rate spread. Lenders must report interest-rate information on certain home purchase loans, refinancings, or home improvement loans secured by a dwelling that they originated. The information must be reported if the "spread" between the annual percentage rate ("APR") on the loan and the yield on comparable Treasury instruments is at least 3 percentage points for first-lien loans or 5

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[7] *See* 12 C.F.R. §§ 528.6 (OTS), 27.3(a) (OCC).

percentage points for subordinate-lien loans. The spread between the APR and the Treasury rate, not the actual APR, is reported.

- HOEPA status (whether originated or purchased loans are covered by the Home Ownership and Equity Protection Act of 1994 ["HOEPA"]), which is determined by whether the upfront fees or annual percentage rate ("APR") on the loan exceed specified thresholds.

- Lien status (loan is secured by a first or subordinate lien on a dwelling or is not secured by a dwelling). This field applies to originated loans and applications that do not result in an origination.

- **Collection of information.** Covered lenders must collect all the information that must be reported. Regulation C provides a form for collection of race, ethnicity, and sex information, which includes a notice explaining that providing the information is voluntary but, when the application is taken in person, the lender will determine race and ethnicity on the basis of visual observation and surname. In telephone applications, the disclosures must be made orally. As noted, collection and reporting of race, ethnicity, and sex is optional for purchased loans.

- **Disclosure of information.** HMDA requires lenders to disclose their information to both the government and the public:

  - The lender must submit information from its LAR to the FRB by March 1 of the year following the year the data were compiled.

  - The lender must provide a copy of a "modified LAR" to any member of the public on request, beginning on March 31 of each year for a request received on or before March 1, and within 30 days of the request thereafter. The LAR must be modified to remove identifying information (the application or loan number, the date that the application was received, and the date action was taken). At the lender's option, the modified LAR may be provided in electronic form on request.

  - The Federal Financial Institutions Examination Council ("FFIEC") uses each lender's LAR to compile a disclosure statement for that institution, tabulating its lending data by various demographic parameters. This statement is generally available by September 1. Lenders must make the disclosure statement available to the public on request, and the FFIEC now posts all of the HMDA disclosure statements on its web site.

  - The FFIEC also produces aggregate reports of the HMDA data, including nationwide, metropolitan, and census-tract tabulations. These reports are also posted on the FFIEC web site.

Phase 1 of HMDA History: Depository Institution Community Reinvestment/Disinvestment Model

Background

When HMDA was enacted, most loans other than those guaranteed by the Federal Housing Administration ("FHA") or another government agency were still being made by savings and loan associations or banks and funded by their deposit liabilities.[8] Development of the secondary mortgage market, which was a precondition to the establishment of a nationwide residential mortgage industry, was still in its early stages. Community advocates and urban politicians argued that depository institutions were withdrawing their investments from, or "disinvesting" in, the communities from which they drew their deposits. This view was reflected in the House Report on the bill that created the beginnings of the HMDA reporting system:

> The withdrawal of private investment capital for home mortgage loans and rehabilitation loans from an increasing number of geographic areas, principally within the nation's major metropolitan centers, exacerbates the problem of providing public sector investments to stabilize and rehabilitate essentially older neighborhoods within our cities and adds to the frustration of millions of Americans denied access to credit at reasonable rates of interest for the sale, improvement and rehabilitation of residential housing.
>
> The process has led to the introduction of the word "red-lining" [*sic*] which increasingly has served to polarize elements of our society in a manner wherein the dialogue has become entirely destructive, rather than constructive. As polarization intensifies, neighborhood decline accelerates. The purpose of this title is, by providing facts, to bring to an end more than a decade of "red-lining" charges and countercharges.[9]

The Chairman of the House Subcommittee that originally reported the bill stated:

> Entire viable neighborhoods of our major central cities, such as Chicago, . . . find their neighborhoods deteriorating to an alarming degree due to the failure of our financial institutions to provide access to credit for the sale and resale and rehabilitation of existing homes, while these same institutions continue to receive the vast majority of their deposits from the citizens [of] these neighborhoods

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[8] *See* Kenneth G. Lore & Cameron L. Cowan, *Mortgage-Backed Securities: Developments and Trends in the Secondary Mortgage Market*, ch. 1:2 (West Group 2003).

[9] H. Rep. No. 94-561, 94th Cong., 1st Sess., at 4 (1975), *reprinted in* 1975 U.S.Code Congr. & Admin. News 2303, 2306.

> who desire to continue to remain in the neighborhoods of their birth.[10]

Thus, the model that underlay the original enactment of HMDA was that depository institutions were draining deposits from urban neighborhoods but failing to "reinvest" those funds in the same urban areas. Shortly thereafter, this model became the basis for enactment of the CRA. The CRA continues to apply only to insured depository institutions, although they have the option of having their affiliates' activities considered.[11]

While the CRA imposes affirmative obligations on insured depository institutions to serve their communities, HMDA's focus has always been on disclosing information about lending patterns. According to the report accompanying the 1975 bill, there was a "compelling necessity" for legislation because the Federal Home Loan Bank Board ("FHLBB"), which then regulated the savings and loans that were the main source of mortgage financing, was unwilling to require such disclosure by regulation:

> [Subcommittee on Financial Institutions Supervision, Regulation and Insurance Chairman Fernand J. St Germain:] All they want to know is what institutions have a commitment to the neighborhoods from whence they are getting their deposits. Are they making a fair reinvestment in these neighborhoods?
>
> Now, doesn't the [FHLBB] have the necessary authority to require this information?
>
> [FHLBB Chairman Thomas R. Bomar]: Mr. Chairman, our attorneys tell me that we do have the authority to require it. We have not required it.[12]

Thus, the original goal of HMDA was simply to require banks and savings and loan associations to make data about their overall geographic lending patterns available to the public.

HMDA Requirements as of Enactment in 1975

Although both the amount and types of data to be reported and the lenders subject to HMDA have expanded considerably since enactment in 1975, the basic structure of the law that was established at enactment has continued.

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[10] *Id.* at 11, *reprinted in* 1975 U.S.Code Congr. & Admin. News 2303, 2312, *quoting* Subcommittee on Financial Institutions Supervision, Regulation and Insurance, Hearings on H.R. 12421, 94th Cong., 2d Sess. (Mar. 5, 1974) (remarks of Rep. St Germain).

[11] *See* 12 U.S.C. § 2902(2) ("regulated financial institution" defined by reference to definition of "insured depository institution" in Federal Deposit Insurance Act ["FDIA"]); *see, e.g.,* FRB Regulation BB, 12 C.F.R. §§ 228.22-228.24.

[12] H. Rep. No. 94-561, 94th Cong., 1st Sess., at 11(1975), *reprinted in* 1975 U.S.Code Congr. & Admin. News 2303, 2312.

Initially, HMDA only applied to depository institutions with assets of more than $10 million that were located, or had a branch located, in a metropolitan area. If covered, these institutions included loans of their majority-owned subsidiaries. A bank or thrift was required to compile summary statistics about its "mortgage loans" and make the data "available . . . to the public for inspection and copying at" its home office and at least one branch office in each metropolitan area in which the institution had a branch, under FRB regulations. A "mortgage loan" subject to HMDA was defined as a loan secured by residential property or a home-improvement loan, regardless of whether that loan was secured. The Board's implementing regulations, however, have restricted the definition of a "mortgage loan" to loans that are made for the purchase of a dwelling, home-improvement loans, or refinancings of those types of loans. Thus, loans to investors, including loans for multi-family properties, are HMDA-reportable, but second-lien loans that are not made as part of a purchase or refinancing are only reportable if they are for the purpose of home improvement.

Institutions were required to tabulate "the number and total dollar amount of mortgage loans" that they either originated or purchased in each metropolitan area, as well as originations or purchases where the property securing the loan was outside any metropolitan area. (The definition of a metropolitan area has changed as the federal government shifted from "standard metropolitan statistical areas" to the current multi-tiered system.[13])

The data also had to be further tabulated by census tract, where data on census tracts were "readily available at a reasonable cost, as determined by the" FRB, or otherwise by zip code. Counties with a population of 30,000 or less did not have to be broken down further. The data also had to be tabulated by the number and dollar amount of:

- FHA, Veterans Administration ("VA"), and Rural Housing Service loans;[14]
- Loans made to investors who did not, at origination, intend to reside in the property; and
- Home improvement loans.

This structure has continued to the present, although there have been significant modifications along the way. For example, HMDA has never required reporting of second-lien loans made outside the context of a purchase or refinancing unless their purpose is home improvement.[15] Loans for other purposes, such as debt-consolidation or education, need not be reported.

1980 Amendments: Centralized Reporting

The original legislation addressed the demands of community groups to be given access to each institution's loan data, but did not provide any centralized source that would

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13 *See supra* note 5.
14 *See* 12 U.S.C. § 2803(b)(1).
15 *See* 12 U.S.C. § 2802(1).

allow comparison of different institutions' lending patterns. Amendments adopted in 1980 required the FFIEC to compile aggregate lending data for every institution with its home office or a branch in each metropolitan area, and to create a depository for that information in each area.[16] The FFIEC continues to maintain those lists, usually at libraries or planning agencies, although the data are now available online as well.[17]

The 1980 amendments also made other changes designed to make the data more meaningful and facilitate comparison among institutions. The amendments:

- Eliminated the option of tabulating loans by zip code rather than census tract;[18]
- Required institutions to tabulate their data on a calendar-year basis rather than use some other fiscal year;[19] and
- Required institutions to use a standard format in reporting their data.[20]

The FFIEC was required to compile and make public aggregate lending data showing the lending activity of institutions by census tract, as well as by groups of census tracts that are categorized by location, age of housing stock, income level, and racial characteristics.[21] Those amendments also required HUD to compile aggregate lending data for FHA lending by institutions that were not subject to HMDA.[22]

By making the data available in a centralized location (albeit initially in a different location in each metropolitan area), requiring the FFIEC to do the work of correlating census tract numbers with demographic information about those areas, and, for the first time, requiring HUD to compile data about non-bank lenders, the 1980 amendments to HMDA took the first step in moving to a model of HMDA as a means of obtaining information about discrimination rather than simply about investment patterns of depository institutions. But because HMDA still provided no information about specific loans or the application process, the focus of HMDA remained on the extent to which institutions were lending in the communities in which their branches were located, and not on how any institution dealt with individual applicants.

1987 Amendments: Extending HMDA to Holding-Company Affiliates

During the 1980s, banks and thrifts increasingly moved their residential mortgage lending activities out of the institution itself and into a holding-company affiliate. In response, the 1987 amendments to HMDA (which became effective in 1988) applied the law for

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16 *See* Pub. L. 96-399, § 340(c), 94 Stat. 1658, *adding* 12 U.S.C. § 2809 (1980).
17 *See* http://www.ffiec.gov/hmda/history2.htm.
18 *See* Pub. L. 96-399, § 340(a)(2), 94 Stat. 1658, *adding* 12 U.S.C. § 2803(a)(2)(A) (1980).
19 *See* Pub. L. 96-399, § 340(a)(3), 94 Stat. 1658, *adding* 12 U.S.C. § 2803(d) (1980).
20 *See* Pub. L. 96-399, § 340(a)(3), 94 Stat. 1658, *adding* 12 U.S.C. § 2803(e) (1980).
21 *See* Pub. L. 96-399, § 340(c), 94 Stat. 1658, *adding* 12 U.S.C. § 2809 (1980).
22 *See* Pub. L. 96-399, § 340(c), 94 Stat. 1658, *adding* 12 U.S.C. § 2810 (1980).

the first time to subsidiaries of bank and savings-and-loan holding companies.[23] This was another step away from strict consideration of depository institutions' lending activities in the areas where they took deposits, but the limited legislative history of the provision suggests that the rationale for the change was to get a better picture of the entire banking organization's lending activities and not to broaden the focus of the legislation to include mortgage lenders in general. As Senator Metzenbaum, one of the proponents of the change, explained:

> Mortgage banking affiliates of bank and S&L holding companies are becoming increasingly important players in providing mortgage finance, often conducting the bulk of mortgage lending for a holding company. Yet, since this type of institution is not covered under HMDA, it is difficult to document how well they serve older urban neighborhoods. Thirteen of the twenty-five largest mortgage companies are controlled by banks and their holding companies.[24]

Under the FRB regulations implementing the 1987 amendments, a "mortgage banking subsidiary" of a bank holding company or savings and loan holding company was subject to HMDA if at least 10% of its dollar loan volume consisted of "home purchase loans" (including refinancings of home purchase loans).[25] As noted, majority-owned subsidiaries of banks and thrifts did not report separately; if the parent institution was subject to HMDA, the subsidiary's data were consolidated with those of the parent.[26] Mortgage banking subsidiaries, like banks and thrifts, were exempt from reporting if they had $10 million or less in assets or had neither a home office nor a branch in a metropolitan area.[27]

The 1987 amendments also made HMDA permanent.[28] Previously the law contained a sunset clause that required it to be periodically reauthorized.

Phase 2 of HMDA History: Mortgage Lender Discrimination Model

1989: FIRREA

The 1989 amendments to HMDA were a small part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), the legislation that extensively reformed and restructured the savings-and-loan industry.

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[23] *See* Housing and Community Development Act of 1987, Pub. L. 100-242, § 565, *amending* 12 U.S.C. § 2802(2) *and adding* 12 U.S.C. § 2803. Under 12 U.S.C. § 2803(g), mortgage-banking holding company subsidiaries were not required to report FHA loans.

[24] 133 Cong. Rec. S4135-04, 1987 WL 934123 (Cong. Rec.) (Mar. 30, 1987).

[25] *See* Board of Governors of the Federal Reserve System, Final Rule: Home Mortgage Disclosure, 53 Fed. Reg. 31683, 31688 (Aug. 19, 1988), *codified at* 12 C.F.R. § 203.2(e)(1)(ii) ("mortgage banking subsidiary" included in definition of "financial institution"), (g) (definition of "home purchase loan").

[26] 53 Fed. Reg. at 31688, *codified at* 12 C.F.R. § 203.2(e)(2).

[27] 53 Fed. Reg. at 31688, *codified at* 12 C.F.R. § 203.3(a).

[28] *See* Housing and Community Development Act of 1987, Pub. L. 100-242, § 565(b), *repealing* former 12 U.S.C. § 2811.

The explicit goal of the 1989 changes was to allow HMDA to be used as a tool to detect discrimination. The section of the bill that made the changes was captioned "Fair Lending Oversight and Enforcement,"[29] and the Conference Report on the legislation stated:

> The Home Mortgage Disclosure Act, as amended by this Act, requires among other things reporting by mortgage lenders to the appropriate regulatory agencies. A primary purpose of such reporting is to assist regulatory agencies in identifying possible discriminatory lending patterns that warrant closer scrutiny. To accomplish this purpose, it is essential that the data submitted to the agencies be in a form that facilitates the task of identifying any discriminatory lending patterns that disadvantage women, minority borrowers, or predominantly minority or low- or moderate-income neighborhoods.[30]

The legislation made dramatic changes in both the range of institutions covered and the amount of information that lenders were required to report:

- Mortgage lenders that were not affiliated with banks, thrifts, or their holding companies were now subject to HMDA.[31]

- Lenders would now have to report on "completed applications" as well as originations and purchases, including reporting withdrawn and rejected applications.[32] The lender could optionally also report the reasons for action taken.[33]

- For most loans, the lender would have to determine and identify the race, sex, and income of loan applicants and borrowers.[34] Loans purchased from another lender were exempt from this requirement, as were loans originated by depository institutions with assets of $30 million or less.[35]

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29 FIRREA, Pub. L. 101-73, 103 Stat. 183, § 1211.

30 H.R. Conf. Rep. No. 222 at 459, 1989 WL 168167 at *498 (Leg.Hist.), 101st Cong., 1st Sess. (1989).

31 FIRREA, Pub. L. 101-73, 103 Stat. 183, § 1211(d), *adding* 12 U.S.C. § 2802(2)(B).

32 FIRREA, Pub. L. 101-73, 103 Stat. 183, § 1211(c), *amending* 12 U.S.C. § 2803(a)(1). A "completed application" was defined as "an application in which the creditor has received the information that is regularly obtained in evaluating applications for the amount and type of credit requested." *See* FIRREA, Pub. L. 101-73, 103 Stat. 183, § 1211(e), *adding* 12 U.S.C. § 2802(3).

33 FIRREA, Pub. L. 101-73, 103 Stat. 183, § 1211(b), *adding* 12 U.S.C. § 2303(h).

34 FIRREA, Pub. L. 101-73, 103 Stat. 183, § 1211(a), *adding* 12 U.S.C. § 2303(b)(4).

35 FIRREA, Pub. L. 101-73, 103 Stat. 183, § 1211(b) and (j), *adding* 12 U.S.C. § 2303(h), (i). Although the FIRREA amendments did not specifically state that loans purchased from another lender were exempt from reporting of demographic information, the Board apparently inferred that they were exempt based on this language in 12 U.S.C. § 2303(h):

> These regulations shall also require the collection of data required to be disclosed under subsection (b)(4) with respect to loans sold by each

- Lenders were also required to identify the "class" of purchaser of a loan.[36] As this requirement was implemented in FRB Regulation C, lenders were required to identify the agency purchasers, such as Fannie Mae, Freddie Mac, or Ginnie Mae, by name, and use a generic indication if the loan is sold to another type of institution such as a commercial bank or life insurance company.[37]

The FRB's implementing regulations modified the tests for HMDA coverage:

- Commenters had criticized the $10-million-asset test because "mortgage companies' assets tend to be low relative to the volume of loans that they originate."[38] In response, although the regulations retained the exemption for independent lenders with $10 million or less in assets, assets of the company's parent were now included in the calculation.

- An unaffiliated mortgage lender was covered if it either had a home or branch office in a metropolitan area or "received applications for, originated, or purchased five or more home purchase or home improvement loans on property located in that" area.[39] Coverage of institutions with no branches in a metropolitan area represented another move away from the model of HMDA as measuring whether deposit-taking institutions "reinvest" in the communities where they take deposits.

- Mortgage banking subsidiaries of holding companies were now treated the same as unaffiliated lenders — they were subject to the same tests for coverage as those lenders, and their HMDA data were no longer consolidated with those of the parent company.[40]

- The regulations retained the exemption for institutions with less than 10% of loan assets in home purchase and refinancing loans.[41]

In implementing the statute, the FRB decided to take over responsibility for summarizing the data from lenders. Accordingly, the Board created a standard LAR form that contained a redacted entry for each completed application or originated or purchased loan. The information from the LAR was incorporated into a summary report for each

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> institution reporting under this title, and, in addition, shall require disclosure of the class of the purchaser of such loans.

The FRB apparently interpreted the requirement to issue regulations requiring institutions to collect data for loans that they sell as implying that data need not be collected for loans that an institution purchases. *See* Board of Governors of the Federal Reserve System, Final Rule: Home Mortgage Disclosure ("Final FIRREA HMDA Rules"), 54 Fed. Reg. 51356, 51360 (Dec. 15, 1989) ("[t]he FIRREA requirement for reporting data on race or national origin, sex, and income does not apply to purchased loans").

36 FIRREA, Pub. L. 101-73, 103 Stat. 183, § 1211(b), *adding* 12 U.S.C. § 2303(h).

37 *See* Final FIRREA HMDA Rules, 54 Fed. Reg. at 51366, *codified at* 12 C.F.R. pt. 203 app. A, § II.C.5 (1990 ed.).

38 54 Fed. Reg. at 51359.

39 54 Fed. Reg. at 51363, *codified at* 12 C.F.R. § 203.2(c)(2).

40 *See* 54 Fed. Reg. at 51359 and 51363, *codified at* 12 C.F.R. § 203.2(e)(2).

41 *See* 54 Fed. Reg. at 51363, *codified at* 12 C.F.R. § 203.3(a)(2).

institution by metropolitan areas, and the same information was used to issue aggregate reports.[42]

Finally, FIRREA also brought United States branches of foreign banks under HMDA.[43]

The FRB Studies

Lenders have long been required to collect racial, ethnic, and gender information about applicants under both Regulation B and specific banking regulations, but this information was not publicly disclosed until the expansion of HMDA reporting. In addition, the value of the information was limited because different requirements applied to different types of lenders.[44] Thus, the expansion of HMDA reporting made the magnitude of denial-disparity ratios clear for the first time.

Consumer advocates quickly responded to the public disclosure of the HMDA data by asserting that the disparity reflected discrimination.[45] FRB staff members published two articles, one in 1991 just after the first year's expanded data had been collected, and another a year later, indicating that the black rejection rate in the database was more than twice the rate for white applicants.[46] But both FRB articles noted that many factors other

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[42] *See* Board of Governors of the Federal Reserve System, Proposed Rule: Home Mortgage Disclosure, 54 Fed. Reg. 41255, 41258 (Oct. 6, 1989).

[43] *See* FIRREA, Pub. L. 101-73, 103 Stat. 183, § 1211(d), *amending* 12 U.S.C. § 2302(2). The definition of a "bank" was changed to incorporate by reference the definition of the term in the FDIA, 12 U.S.C. § 1813(a). At the same time, FIRREA amended the FDIA definition to include branches of foreign banks. *See* FIRREA, Pub. L. 101-73, 103 Stat. 183, § 204(a).

[44] For example, lenders that were not subject to the jurisdiction of banking regulators were initially required under Regulation B to maintain monitoring information about purchases (but not refinancings) of 1-4-family residential real property. *See* Board of Governors of the Federal Reserve System, Amendments to Regulation B to Implement the 1976 Amendments to the Equal Credit Opportunity Act , 42 Fed. Reg. 1242, 1261-62 (Jan. 6, 1977), *adding* 12 C.F.R. § 202.13. In 1985, the requirement was expanded to include refinancings and to include the principal dwelling of the applicant even if it was not real property, but to exclude investor purchases (which are covered by HMDA). *See* Board of Governors of the Federal Reserve System, Revision of Regulation B, Final Rule and Final Official Staff Interpretation, 50 Fed. Reg. 48018, 48033 (Nov. 20, 1985). The Regulation B requirement has also never covered home-improvement loans. The banking regulators imposed their own, different requirements. *See, e.g.,* 12 C.F.R. §§ 27.3(b)(2) (OCC), 338.4(a)(1)(C) & (D) (Federal Deposit Insurance Corporation), & 528.6(d)(2)(v) (OTS) (1989 ed.). For example, the OCC required the collection of information on purchases, construction-to-permanent loans, and refinancings, while the OTS required it for all loans related to a dwelling. Until recently, the Federal Housing Administration ("FHA") also maintained a program of "negative reporting," in which FHA lenders that were exempt from reporting under HMDA notified HUD annually that they were exempt. *See* FHA Mortgagee Letter 95-3: Home Mortgage Disclosure Act (HMDA) Update (January 5, 1995) (instituting the program); Memorandum from Patricia Dykes, Manager, CRA/HMDA Operations Unit, Federal Reserve Board (Nov. 23, 2004), *available at* http://www.ffiec.gov/hmda/pdf/HUDtransfer.pdf (announcing discontinuance of program).

[45] *See, e.g.,* Susan Schmidt, *Lending Bias Abounds, Says Housing Group,* Wash. Post, Dec. 20, 1991, at B10.

[46] *See* Glenn B. Canner & Dolores S. Smith, *Home Mortgage Disclosure Act: Expanded Data on Residential Lending*, 77 Fed. Reserve Bull. 859 (1991); Glenn B. Canner, *Expanded HMDA Data on Residential Lending: One Year Later,* 78 Fed. Reserve Bull. 859 (1992).

than race, such as income and underwriting factors, also contribute to disparities in rejection rates.[47]

Nevertheless, the release of the HMDA data, coupled with analyses based on the data, led many to believe that there was a serious problem of discrimination in mortgage lending. In response to the release of the HMDA data and concerns about differential denial rates, the Federal Reserve Bank of Boston ("Boston Fed") attempted to overcome the limitations of the data by obtaining application data from 130 Boston-area banks that contained data used in underwriting. The resulting report is known as the Boston Fed Study. The Boston Fed Study compared denial rates of whites and minorities (African-Americans and Hispanics), taking into account factors such as credit history and the loan-to-value ratio in addition to the factors reported in the HMDA data.[48] Although the study found that much of the disparity in reported HMDA results was attributable to these and other legitimate factors, the final version of the study concluded that minority applicants were about 80% more likely than whites to be denied a loan, even after considering underwriting factors that are not included in the HMDA data.[49]

The Boston Fed Study has been very controversial. Critics have noted the many data errors in the data used to construct the model.[50] Observers who have questioned the Boston Fed Study have also argued that the design of the study was flawed for other reasons. These issues raised by the Boston Fed Study are discussed in more detail below, along with an analysis of the severe limitations of HMDA data as evidence of discrimination.

In any case, the premise of the Boston Fed Study was that HMDA data, standing alone, were insufficient to demonstrate or disprove that a lender was discriminating. Therefore, it was necessary to augment the HMDA information with additional information that the lender considered in underwriting. As also discussed below, despite the continuing controversy over the validity of the Boston Fed Study, government agencies charged with enforcing the fair lending laws do not regard HMDA data by themselves as evidence of discrimination. They also have declined to use statistical analyses of HMDA data that have been "augmented" with additional information about the underwriting process that is not reported under HMDA as a tool to detect discrimination.

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[47] *See id.*

[48] Alicia H. Munnell *et al., Mortgage Lending in Boston: Interpreting HMDA Data,* Fed. Res. Bank of Boston, Working Paper WP-92-7 (Oct. 1992), *presented in revised form in* Alicia H. Munnell, *et al., Mortgage Lending in Boston: Interpreting HMDA Data ("Boston Fed Study II"),* 86 Am. Econ. Rev. 25 (1996), vol. 86, no. 1 (Mar. 1996).

[49] *Boston Fed Study II* at 26 (noting a ratio of 1.8 to 1 in denial rates, which equates to an 80% increased likelihood of being denied for minorities).

[50] *See* Stanley D. Longhofer, *Discrimination in Mortgage Lending: What Have We Learned?*, in Fed. Res. Bank of Cleveland, 1996 Economic Commentary, *available at* http://www.clevelandfed.org/Research/com96/081596.htm (last visited Feb. 21, 2005), *citing* David K. Horne, *Evaluating the Role of Race in Mortgage Lending,* 7 FDIC Banking Rev. 1–15 (1994); Ted Day & Stan J. Leibowitz, *Mortgages, Minorities, and Discrimination,* University of Texas at Dallas, unpublished manuscript (1993).

Industry Response to the 1989 HMDA Data and Studies

Although lenders shared the skepticism of many scholars as to whether the Boston Fed Study demonstrated discrimination or simply reflected disparities in the economic position of whites and minorities, the industry responded proactively to criticisms of their minority and low-income lending records. Mortgage lenders:

- Instituted programs such as "second review" procedures, in which some or all rejected minority applications are reviewed to ensure that the consumer has been treated fairly and that all potential products had been considered.[51]
- Expanded their underwriting standards to eliminate unnecessary impediments to loan approvals, and created new products that are more accessible to low-income and credit-impaired borrowers.
- Worked with the GSEs to make the GSEs' underwriting standards more flexible and more suitable for those borrowers and to develop new products aimed at that market.
- Expanded outreach programs.

These changes in lenders' practices had a significant impact on the availability of credit to lower-income and minority borrowers. For example, "[a]nnual mortgage originations for African-Americans, Hispanics, and members of other minority groups . . . jumped about 130%" between 1990, the first year of expanded HMDA reporting, and 1996 — a rate that was "nearly twice the growth rate of the total market."[52]

1991: Change in Small Mortgage-Banker Exemption

Although the FRB had modified the $10 million asset cutoff to include assets of the parent corporation, critics continued to contend that the exemption was inappropriate for non-bank mortgage banking companies because they generally do not hold assets in portfolio, and, therefore, have low assets compared to a depository institution with a similar level of lending activity. Congress in 1991 replaced the fixed amount with a directive to the Board to set a cutoff for mortgage bankers that is comparable to the figure for banks and thrifts.[53]

In implementing the congressional directive, the FRB expanded the definition to include some non-bank lenders with assets under $10 million. It adopted a three-part test for coverage of "a for-profit mortgage-lending institution (other than a bank, savings association, or credit union)." Such a lender was now covered if it:

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[51] *See, e.g.*, Barbara Rehm, *New Action on Minority Loan Front: Mortgage Group Prepares to Sign Pact with HUD*, Am. Banker, Aug. 23, 1994, at 1 (describing agreement between trade association and Department of Housing and Urban Development that specified fair-lending best practices, including a second review program).

[52] Jaret Seiberg, *Banks Making Good Progress In Their Fair-Lending Efforts*, Am. Banker, Sept. 16, 1996, at 1.

[53] *See* Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. 102-242, 105 Stat. 2236, § 224, *amending* 12 U.S.C. § 2808(a).

- Originated home-purchase loans in the preceding calendar year (including refinancing of purchase loans) equal to 10% of its loan-origination volume;
- Had a home or branch office in a metropolitan area as of the preceding December 31; and
- Either had assets of more than $10 million, including the assets of any parent, as of the preceding December 31, or originated at least 100 home-purchase loans, including refinancings of such loans, in the previous calendar year.[54]

1992: LARs Must Be Disclosed

As noted, the disparity in rejection rates reported in the FRB articles generated very negative publicity for the mortgage industry, particularly because much of the news reporting did not include the caveat in those FRB articles recognizing that comparative rejection rates are not, in themselves, evidence of discrimination. The Housing and Community Development Act of 1992 reflected the attention that the new HMDA data had generated — it required institutions to disclose the contents of their LAR to the public, with information that would compromise privacy deleted.[55] Institutions must provide the modified LAR by March 31 of each year, for a request received by March 1, and within thirty days of a request received after March 31.[56] They may charge a reasonable fee for the disclosure.[57]

The 1992 amendments also set deadlines for the FFIEC to produce its reports — September 1 for the reports of each institution's activity and December 1 for the aggregate reports. The FFIEC was also strongly encouraged, as of 1994 and succeeding years, to begin producing the institution-specific reports by July 1 and the aggregate reports by September 1.[58]

Thus, the FRB's decision to require submission of LARs — framed as a way of easing lenders' compliance burden — resulted in short order in some significant details about each loan being made available to the public, with the potential for fair lending liability.[59] Although the direct burden of providing the LARs may be lower than the old system that required lenders to assemble the information, the cost of a fair lending lawsuit or government enforcement action generated by the data in the LARs could far exceed any savings from having the FFIEC perform the analysis.

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[54] *See* Board of Governors of the Federal Reserve System, Final Regulatory Amendments: Home Mortgage Disclosure, 57 Fed. Reg. 56963, *codified at* 12 C.F.R. § 203.3(a)(2)(ii) (Dec. 2, 1992).

[55] Housing and Community Development Act of 1992, Pub. L. 102-550, § 932(a), 106 Stat. 3672, *adding* 12 U.S.C. § 2803(j).

[56] *Id.*

[57] Housing and Community Development Act of 1992, Pub. L. 102-550, § 932(a), 106 Stat. 3672, *adding* 12 U.S.C. § 2803(j).

[58] Housing and Community Development Act of 1992, Pub. L. 102-550, § 932(a), 106 Stat. 3672, *adding* 12 U.S.C. § 2803(*l*).

[59] *See, e.g.*, Allen J. Fishbein, *Fair Housing Conference: Home Mortgage Disclosure Act Report,* 28 J. Marshall L. Rev. 343 (1995).

1996: Updated and Indexed Small-Bank Exemption

In 1996, the small-depository-institution exemption was indexed for the cost of living. A one-time adjustment was made from $10 million to $28 million for the increase in the Consumer Price Index from 1975 to 1996, and the law provided for annual indexing thereafter.[60] The level for 2005 is $34 million.[61] The exemption for non-banking lenders, however, was still based on the equivalent of a $10-million-asset depository institution.[62]

The 1996 amendments also made other changes designed to "reduce [the] compliance burden" created by HMDA:

- A lender could avoid having to maintain copies of LARs and disclosure statements at a branch in each metropolitan area by posting a notice in at least one branch per area that the information was available at its home office on request. The home office was required to provide the information relating to the location of a branch within 15 days of receiving a request.[63]

- Lenders were also given the option of providing the information using an electronic medium such as a computer disk, if this format was acceptable to the requester.[64]

Phase 3 of HMDA History: Predatory Lending/Pricing Discrimination Model

The changes in lender policy in response to the expansion of HMDA reporting were one contributing factor in the growth of lending to a wider range of borrowers. Another factor was the development of credit scoring technology, which facilitated the creation of a secondary market for nontraditional loans. As a result of these developments, more and more consumers were able to obtain credit, but there was much greater variation in pricing. In addition, the "predatory lending" issue drew increasing attention from advocates and some members of Congress. Lenders were now being criticized, not for redlining — avoiding minority and low-income areas — but for "targeting" or "reverse redlining" — expressly seeking out minority or low- and moderate-income borrowers for nonprime loans at higher rates and more onerous terms than conventional conforming loans.

The third phase of HMDA reflects the change in focus to predatory lending and the nonprime market. In addition, the FRB has attempted to improve the general quality and consistency of HMDA reporting and of how it is presented. In contrast to the first two

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60 *See* Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA"), Pub. L. 104-208, § 2225(a), 110 Stat. 3009, *adding* 12 U.S.C. § 2808(b). The Board made the initial adjustment by regulation. *See* Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Interim Rule, 62 Fed. Reg. 3603 (Jan. 24, 1997); Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule, 62 Fed. Reg. 28620 (May 27, 1997).

61 *See* Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule and Staff Commentary, 69 Fed. Reg. 77139 (Dec. 27, 2004).

62 *See* EGRPRA, Pub. L. 104-208, § 2225(a), 110 Stat. 3009, *adding* 12 U.S.C. § 2808(b).

63 *See* EGRPRA, Pub. L. 104-208, § 2225(b), 110 Stat. 3009, *adding* 12 U.S.C. § 2803(m)(1).

64 *See* EGRPRA, Pub. L. 104-208, § 2225(b), 110 Stat. 3009, *adding* 12 U.S.C. § 2803(m)(2).

phases, the recent extensive changes to HMDA requirements have been driven entirely by FRB regulation. There has been no new legislation requiring additional reporting.

The most recent revisions grew out of the FRB's periodic review of Regulation C (as well as its other regulations).[65] The most significant change was to require lenders, as of January 1, 2004, to report loan pricing on loan originations with rates above a certain threshold — those in which the APR exceeds the yield for comparable U.S. Treasury securities by 3 percentage points for first-lien loans and 5 percentage points for subordinate-lien loans.[66] The spread over comparable Treasuries, rather than the actual APR, is reported.[67] Along the same lines, lenders must report the lien status of the loan, whether it is covered by HOEPA, and whether it is secured by a manufactured home.[68] The FRB hopes that this information will reveal more information about whether certain lenders are targeting minorities or lower-income borrowers for above-threshold loans:

> Obtaining loan pricing data is critical to address fair lending concerns related to loan pricing and to better understand the mortgage market, including the subprime market. The mortgage marketplace has changed significantly since HMDA was enacted and continues to evolve. Along with a substantial growth in the subprime market has come increased variation in loan pricing, generally related to an assessment of credit risk. In light of these changes, the Board believes that the collection of loan pricing information is necessary to fulfill the statutory purposes of HMDA and to ensure the continued utility of the HMDA data.[69]

The FRB also adopted several changes designed to improve the quality and precision of HMDA data. Most significantly, as noted above, HMDA had long required lenders to collect race, ethnicity, and gender information about applicants, including making a judgment about those factors if the applicant declined to state it in a face-to-face interview. But lenders were not required to request the information in a telephone application. Because of the increasing number of applications taken by telephone, the regulation was amended as of January 1, 2003, to require lenders to request the information in those applications.[70]

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[65] *See* Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Advance Notice of Proposed Rulemaking, 63 Fed. Reg. 12329 (Mar. 12, 1998).

[66] *See* Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule and Staff Interpretation, 67 Fed. Reg. 43218, 43223 (June 27, 2002), *amending* 12 C.F.R. § 203.4(a).

[67] *See id.*

[68] *See id.; see* Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule and Staff Interpretation, 67 Fed. Reg. 7222, 7223, and 7237 (Feb. 15, 2002), *amending* 12 C.F.R. § 203.4(a).

[69] Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule and Staff Interpretation, 67 Fed. Reg. at 7228 (Feb. 15, 2002).

[70] *See* Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule and Staff Interpretation, 67 Fed. Reg. 43217 (June 27, 2002), *amending* 12 C.F.R. pt. 203 app. A, § V.D.2.

The FRB made other, technical changes designed to improve the consistency of HMDA reporting, which went into effect on January 1, 2004. They included:

- The definitions of refinancings and home-improvement loans were made more precise, and lenders lost the option of treating certain loans as refinancings when they did not meet the precise definition.[71]

- HMDA now applies to certain applications for "preapproval," defined narrowly to cover only loans that are fully underwritten and in which the lender issues a written, time-limited commitment in which the only substantive condition is locating a suitable property.[72]

Finally, the FRB expanded coverage of nondepository lenders by including lenders that make $25 million or more in mortgage loans under HMDA even if less than 10% of their loan-origination volume was home-purchase loans or refinancings of those loans.[73] Previously, many nonprime lenders that focus on providing home equity loans had not been HMDA reporters because of this exemption.

II. Limitations of the HMDA Data and of Statistical Analysis of Discrimination

The HMDA Data Are Not Evidence of Discrimination

The federal agencies that enforce the fair lending laws generally do not use HMDA data directly in enforcing these laws, because they acknowledge that the HMDA data do not include the factors actually considered in determining whether a loan is to be made and at what price. Most significantly, the data do not indicate the underwriting factors that are most important to the loan decision, including the lender's assessment of the applicant's credit and employment history, the applicant's assets, and debt-to-income and loan-to-value ratios.

Because of these limitations, the banking agencies, which have created specific enforcement procedures, use the data as an "indicator" of potential redlining. More significantly, since the main method of enforcement is to compare minority and non-minority "marginal applicants," the agencies use HMDA data to identify those applicants.[74] They do not attempt to replicate the approach of the Boston Fed Study of augmenting the HMDA data with other information to construct a statistical model of lending performance.

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[71] *See* Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule and Staff Interpretation, 67 Fed. Reg. 7222, 7223, & 7237, *amending* 12 C.F.R. § 203.2(g) and (k).

[72] *See* Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule and Staff Interpretation, 67 Fed. Reg. 7222, 7223, *adding* 12 C.F.R. § 203.2(b)(2).

[73] *See* Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule and Staff Interpretation, 67 Fed. Reg. 7222, 7223, *adding* 12 C.F.R. § 203.2(e)(2)(i)(B). Institutions with $25 million in mortgage-loan volume still had to (1) have a home or branch office in a metropolitan area; and (2) either have assets, including assets of a parent, of more than $10 million; or have made at least 100 home-purchase loans (including refinancings of such loans) in the previous year. 12 C.F.R. § 203.2(e)(2)(ii) and (iii).

[74] The Justice Department also often follows the approach of comparing matched pairs of marginal applicants.

The FRB and other government agencies charged with collecting the data and enforcing the law have recognized that HMDA data cannot prove illegal discrimination. One of the FRB staff articles on HMDA noted:

> The HMDA data have clear limitations. Foremost among them is the general lack of information about factors important in assessing the creditworthiness of applicants and the adequacy of collateral offered as security on loans. Without such information, determining whether individual applicants have been treated fairly is not possible.[75]

An Interagency Policy Statement on fair lending issued shortly after, and partially in response to, the Boston Fed Study made a similar point:

> Data reported by lenders under the HMDA do not, standing alone, provide sufficient information for such an analysis because they omit important variables, such as credit histories and debt ratios. HMDA data are useful, though, for identifying lenders whose practices may warrant investigation for compliance with fair lending laws. HMDA data may also be relevant, in conjunction with other evidence, to the determination whether a lender has discriminated.[76]

Reflecting these limitations, the FFIEC's fair lending examination procedures specifically instruct examiners *not* to treat patterns revealed by HMDA data as evidence of "disparate impact" discrimination:

> Gross HMDA denial or approval rate disparities are not appropriate for disproportionate adverse impact[77] analysis because they typically cannot be attributed to a specific policy or criterion.[78]

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75 Glenn B. Canner, *supra note* 46.

76 Department of Housing and Urban Development *et al., Policy Statement on Discrimination in Lending,* 59 Fed. Reg. 18266, 18269 (Apr. 15, 1994).

77 As described by the agencies, there are three main types of lending discrimination:

- [O]vert evidence of discrimination," when a lender blatantly discriminates on a prohibited basis;
- [E]vidence of "disparate treatment," when a lender treats applicants differently based on one of the prohibited factors; and
- [E]vidence of "disparate impact," when a lender applies a practice uniformly to all applicants but the practice has a discriminatory effect on a prohibited basis and is not justified by business necessity.

Id., 59 Fed. Reg. at 18268 (Apr. 15, 1994).

78 FFIEC, Interagency Fair Lending Examination Procedures, app. at 26 (1999), *available at* http://www.ffiec.gov/pdf/fairappx.pdf (emphasis in original).

The FFIEC's guidelines do permit consideration of patterns in HMDA data in identifying "indicators of potential discriminatory [r]edlining"[79] (a form of "disparate treatment" discrimination) where the HMDA data reveal "[s]ignificant differences in the number of loans originated in those areas in the lender's market that have relatively high concentrations of minority group residents compared with areas with relatively low concentrations of minority residents."[80] But the HMDA data are used only as an initial screen, not to prove that redlining is occurring.[81]

Given the finding of the Boston Fed Study that fair lending problems occurred with marginal applicants, rather than either highly qualified or clearly unqualified borrowers, the main use of HMDA data in banking agency fair lending enforcement is to help the examiner find "marginal" transactions for comparison.[82] The rationale for this approach is as follows:

> A principal goal is to identify cases where similarly qualified prohibited basis and control group applicants had different credit outcomes, because the agencies have found that discrimination, including differences in granting assistance during the approval process, is more likely to occur with respect to applicants who are *not* either clearly qualified or unqualified, i.e., **"marginal"** applicants. The examiner-in-charge should, during the following steps, **judgmentally select** from the initial sample only those denied and approved applications which constitute **marginal transactions.**[83]

Thus, the enforcement agencies have not attempted to use HMDA data or other statistics in the way that the Boston Fed did, in an attempt to demonstrate discrimination directly. Rather, the HMDA data are generally used as an "indicator" that further "judgmental," rather than statistical, inquiry is warranted, although they could also be used as part of a redlining case.

Although the banking agencies have not yet revised their examination procedures in light of the expanded HMDA data on pricing, in issuing the revised HMDA regulations, the FRB made it clear that it views the new information as a trigger for further inquiry, not as evidence, in itself, of discrimination:

> This [pricing] information would facilitate identification of subprime loans, which have different characteristics, such as higher denial rates, from other mortgage loans. Pricing information could also help identify practices that raise

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79 FFIEC, Interagency Fair Lending Examination Procedures at 8-9 (1999), *available at* http://www.ffiec.gov/PDF/fairlend.pdf.

80 *Id.* at 9.

81 *See id.* at 30.

82 *See id.* at 16.

83 *Id.* at 17 (emphasis in original).

potential fair lending concerns warranting further investigation.[84]

Weaknesses in the Boston Fed Study

Although the federal enforcement agencies recognize that HMDA data standing alone are insufficient to prove discrimination, it might be thought that they would support use of the approach taken in the Boston Fed Study, in which those data were supplemented with underwriting information. The Interagency Policy Statement appeared relatively soon after the initial Boston Fed Study was released and cites it favorably. For that reason, it is noteworthy that neither the Policy Statement nor the later FFIEC examiner guidelines endorses the use of augmented HMDA data to determine whether discrimination has occurred.

The agencies may have decided not to embrace the approach of the Boston Fed Study because of the many problems noted by critics in the design of that study. These issues included:

- The method of statistical analysis used, the "logit" method, can theoretically detect discrimination "where none exists, yet fail to uncover even egregious cases of bias."[85]

- Even with the augmented data in addition to HMDA information, the Boston Fed Study did not consider several factors that may have contributed to loan decisions, such as whether the borrower submitted information that could not be verified and whether the borrower met the institution's guidelines.[86] Since those factors also correlate with race or ethnicity, part or all of the difference in acceptance rates could be due to these legitimate omitted variables rather than to race or ethnicity.[87]

- The model assumed that all lenders applied the same underwriting standards to each applicant. If this assumption is incorrect, then some of the differences in denial rates could reflect differences in the proportion of minorities and whites who apply to different institutions or who apply for specialized programs at different institutions. For example, if an institution operates an aggressive outreach program to attract more

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[84] Board of Governors of the Federal Reserve System, Home Mortgage Disclosure: Final Rule and Staff Interpretation, 67 Fed. Reg. 7222, 7229 (Feb. 15, 2002) (emphasis added).

[85] Stanley D. Longhofer, *supra* note 50, *citing* Paul W. Bauer & Brian A. Cromwell, *A Monte Carlo Examination of Bias Tests in Mortgage Lending,* Fed. Res. Bank of Cleveland Econ. Rev., vol. 30, no. 3 at 27 (1994); Anthony M.J. Yezer, Robert F. Phillips, & Robert P. Trost, Bias in Estimates of Discrimination and Default in Mortgage Lending: The Effects of Simultaneity and Self-Selection," Journal of Real Estate Finance and Economics, vol. 9, no. 3 (November 1994), pp. 196–215.

[86] *See, e.g.,* Mark Zandi, *Boston Fed's Bias Study Was Deeply Flawed,* Am. Banker, Aug. 19, 1993, at 13 (also noting that a housing recession that occurred during the period studied had a disproportionate impact on housing prices at the low end of the market, where minority borrowers are more likely to be found). *See generally* Stephen L. Ross & John Yinger, *The Color of Credit: Mortgage Discrimination, Research Methodology, and Fair-Lending Enforcement* 108-130 (2002).

[87] *But see* Jason Dietrich, *Under-Specified Models and Detection of Discrimination in Mortgage Lending:* OCC *Economic and Policy Analysis Working Paper,* March 2003, available at http://www.occ.treas.gov/ftp/workpaper/wp2003-2.pdf (no clear direction of increased or decreased discrimination when omitted variables were added in national bank fair lending examinations).

minority applicants (including those with marginal credit qualifications), it may, paradoxically, increase the ratio of minority to non-minority denials.[88]

- If the assumption is that lenders were biased against minorities, minorities should have had, but did not have, lower default rates because they would have had to be better qualified to overcome the lender's biases. Advocates of this position included Nobel prizewinner Gary Becker.[89]

Other analysts defended the Boston Fed Study, noting, for example, that Prof. Becker's analysis assumed that lenders had a "taste for discrimination" — *i.e.,* were willing to forgo profits in order to discriminate against minorities — while the law also prohibits "statistical" discrimination, in which the lender can profit by discriminating "if the overall pool of minority applicants is less creditworthy on average than the white applicant pool."[90]

The enforcement agencies have apparently concluded, however, that the many unresolved questions in the Boston Fed Study outweigh whatever value that approach might have in drawing any firm conclusions about discrimination in mortgage lending. As an economist with the Federal Reserve Bank of Cleveland put it:

> So, does widespread discrimination exist in the home mortgage market? Ultimately, the answer must be "we don't know." Taken together, the problems with the Boston Fed data set (including its limited geographic focus), questions about the robustness of logit analysis, and limitations of other methods for detecting discrimination all combine to lead most economists to conclude that we still don't have a definitive answer about the presence of widespread and systematic discrimination in the home mortgage market.[91]

Even with Pricing Information, HMDA Data Will Not Show Discrimination

With the new reporting of pricing information, there will likely be claims that disparities in the incidence of higher-cost loans to minority groups are evidence of discrimination. As noted above, however, without information about the underwriting factors that lenders actually used, even the expanded HMDA data will not, in themselves, demonstrate that discrimination has occurred. Many components go into a pricing decision, including not only underwriting factors, which are not reported under HMDA, but also the dynamics of the market, which are influenced by both a lender's funding reserves at any given time and the borrower's specific choices as to loan terms. In addition, the APR spread is an

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88 *See generally* Stephen L. Ross & John Yinger, *supra* note 86, at 169-212 (2002).

89 Gary S. Becker, *The Evidence Against Banks Doesn't Prove Bias,* Bus. Week, Apr. 19, 1993, at 18.

90 Stanley D. Longhofer & Stephen R. Peters, *Beneath the Rhetoric: Clarifying the Debate on Mortgage Lending Discrimination,* Fed. Res. Bank of Cleveland Econ. Rev., 1998 quarter 4, at 5.

91 Stanley D. Longhofer, *Discrimination in Mortgage Lending: What Have We Learned?, supra* note 50.

imperfect measure of the cost of the loan to the consumer. For example, the APR does not reflect many closing costs and thus does not take into account a borrower's decision to avoid closing costs by paying a higher rate.

All of the complexities of modeling lending behavior that were identified as shortcomings of the Boston Fed Study negate any simplistic conclusions that might be drawn from HMDA price disparities. It is extremely difficult to capture all the factors that may have contributed to pricing decisions, especially when those factors include choices made by individual borrowers as to loan products, terms, loan amounts, and financing structures.

Release of 2004 HMDA Pricing Data

On September 13, 2005, the FFIEC announced the availability of HMDA data for the year 2004 regarding mortgage lending transactions at 8,853 financial institutions in metropolitan statistical areas throughout the nation. As noted, the HMDA data reflect new information collected relating to loan pricing, whether a loan is covered by HOEPA, whether a loan is secured by a first or subordinate lien, or is a manufactured home.

The aggregate 2004 data show that the incidence of higher-priced lending (that is, the proportion of loans that are higher-priced) varies by loan product, lender, geographic market, race, and ethnicity. The FFIEC made clear that the HMDA data are not, by themselves, a basis for definitive conclusions regarding whether a lender discriminates unlawfully against particular borrowers or takes unfair advantage of them. For example, the HMDA data do not include certain determinants of credit risk that some lenders consider in pricing mortgage loan products, such as the borrower's credit history, loan-to-property-value ratio, and consumer debt-to-income ratio. The FFIEC indicated that conclusions from the HMDA data alone, therefore, run the risk of being unsound, which in turn may reduce the data's effectiveness in promoting HMDA's objectives. Nevertheless, the HMDA pricing data are expected to serve as a useful screening tool for identifying institutions that warrant further scrutiny.[92]

Federal Reserve board staff economists and consumer affairs specialists also published a comprehensive article describing and explaining the HMDA data. Among other things, the article indicates that considering the raw data, the differences between non-Hispanic whites and minorities (particularly blacks) in the incidence of high-priced lending are generally more than 20 percentage points for various loan products. The analysis shows, however, that more than two-thirds of the aggregate difference in the incidence of higher-priced lending between black and non-Hispanic white borrowers can be explained by differences in the groups' distributions of income, loan amounts, other borrower-related characteristics included in the HMDA data, and the choice of lender. The report further indicates that this narrowing suggests that controlling for credit-related factors not found in the HMDA data, such as credit history scores and loan-to-value ratios, might further

[92] *See* Avery, Canner, and Cook, "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," Fed. Res. Bull. 344, 379-80 (Summer 2005), available at http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf

reduce unexplained racial or ethnic differences. It is expected that this new data will undergo much additional analysis by the lending industry, regulators, and consumer advocacy organizations.

Reaction to 2004 HMDA Pricing Data: Department of Justice and New York State Actions

Some observers predicted that release of the HMDA pricing data would result in a spate of private class action lawsuits. Extensive private litigation has thus far not materialized, presumably because of the limitations in the publicly-released data discussed above. On the other hand, release of the data did trigger interest on the part of federal and state enforcement agencies. In December 2005, it was reported that the U.S. DOJ had recently issued requests for information to lenders that the Board had identified as having potentially engaged in discriminatory lending activities based upon HMDA data.[93] The FRB had reportedly identified about 200 lenders whose data, after applying a statistical model, suggested racial and ethnic disparities in their lending practices. The FRB sent the names of those lenders either to their principal banking regulator or the DOJ, as appropriate. The DOJ followed up by requesting several lenders to voluntarily provide more information about their lending practices, including some information that is not reported under HMDA such as applicants' and borrowers' credit scores.

On the state level, Eliot Spitzer, the New York Attorney General, began an inquiry into the mortgage lending practices of a number of large banks that do business in New York State, including some national banks and their operating subsidiaries. The banks were targeted on the basis of a preliminary analysis of pricing disparities in the banks' publicly-available 2004 HMDA data.[94] Mr. Spitzer asserted that the racial disparities in pricing revealed by the HMDA data were sufficient to make out a *prima facie* case of race discrimination in violation of federal and state laws prohibiting credit discrimination.[95] He asserted that he had the authority to enforce those laws against national banks and their subsidiaries.

The OCC and the Clearing House Association, whose members include several of the national banks targeted by the inquiry, filed separate lawsuits seeking to enjoin the inquiries on the grounds that the OCC has exclusive visitorial authority over national banks and their operating subsidiaries and that the Attorney General has no authority either to investigate those lenders or to sue them for violations of either federal or state law. On October 12, 2005, the U.S. District Court for the Southern District of New York granted a declaratory judgment in favor of the OCC and an injunction in favor of the

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[93] *See* charlotte.com (the Charlotte Observer), Dec. 1, 2005, *available at* http://www.charlotte.com/mld/charlotte/business/industries/13298330.htm?template=contentModules/printstory.jsp (last visited Feb. 14, 2006).

[94] *See OCC v. Spitzer*, 396 F. Supp. 2d 383, 385-86 (S.D.N.Y. Oct. 12, 2005).

[95] *See* Defendant's Memorandum of Law in Opposition to Plaintiffs' Request for Injunctive and Declaratory Relief and in Support of Counterclaim at 6, *Clearing House Ass'n v. Spitzer*, 394 F. Supp. 2d 620 (S.D.N.Y. 2005) and *OCC v. Spitzer*, 396 F. Supp. 2d 383 (S.D.N.Y. 2005) (Nos. 05 Civ. 5629 and 05 Civ. 5636).

Clearing House Association, preventing Mr. Spitzer from continuing his inquiry.[96] The Attorney General has appealed both decisions.

Thus, disparities the HMDA pricing data, when augmented by additional information available to enforcement agencies, may expose lenders to government enforcement actions. The federal DOJ's investigation could result in actions against a number of lenders. Although Attorney General Spitzer's investigations into national banks and their subsidiaries have been blocked by the courts, preemption does not prevent him or other state enforcement authorities around the country from investigating and bringing enforcement actions against state-chartered or regulated lenders.

Conclusion

The focus of HMDA has gradually shifted from a concern with whether banks and thrifts were lending in the neighborhoods in which they collected deposits, to a more general inquiry into whether lenders of all types were discriminating, to the current emphasis on whether vulnerable groups, including minorities, are being targeted with unfavorable rates and terms. This shift has generally reflected changes in how mortgages are made, from an activity of local banks and savings and loans to a nationwide industry in which many of the major players are not depository institutions, although many are bank and thrift affiliates. Although the trend has been to collect more and more information, including pricing information, HMDA data still do not include most factors considered in underwriting, and, therefore, should not be used to conclude that a lender is discriminating. Moreover, because of the many problems in designing a valid study, even adding underwriting factors that the lender considered may not allow a firm conclusion as to whether it is engaged in discrimination.

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[96] *See OCC v. Spitzer*, 396 F. Supp. 2d 383 (S.D.N.Y. Oct. 12, 2005); *Clearing House Ass'n v. Spitzer*, 394 F. Supp. 2d 620 (S.D.N.Y. Oct. 12, 2005).

The Gap Persists

A Report on Racial and Ethnic Discrimination in the

Greater Boston Home Mortgage Lending Market.

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May 2006

Introduction

During the four months from October 2005 to January 2006, the Fair Housing Center of Greater Boston (Fair Housing Center) conducted an investigation to determine the extent and nature of discrimination by mortgage lenders in Greater Boston against African American, Latino, Asian, and Caribbean homebuyers. The Fair Housing Center used trained volunteers to call and visit banks and mortgage offices and to report in detail on their experiences. Overall, the Fair Housing Center found differences in treatment which disadvantaged the homebuyer of color in nine of the twenty matched paired tests conducted, or 45 percent.

This report summarizes these findings and places them in the broader context of the otherwise well-documented segregated residential patterns and racial and ethnic disparities in mortgage lending in Greater Boston. The report is organized into the following seven sections:

Section I gives a brief description of the Fair Housing Center's mission and programs.

Sections II provides background on the need for a study of discrimination in the region's mortgage lending market.

Section III describes the laws and regulations relevant to the investigation.

Section IV presents a summary of the methods the Fair Housing Center used in conducting its investigation.

Section V reports the findings, with information on the occurrences of discrimination and examples of the types of discriminatory behavior encountered by testers.

Section VI discusses the findings and their implications.

Section VII provides a series of recommendations for further action.

I. About the Fair Housing Center of Greater Boston

Founded in 1998 by local civil rights and housing advocates and attorneys, the Fair Housing Center of Greater Boston (Fair Housing Center) works to eliminate housing discrimination and promote open communities throughout the region. We pursue this mission

through four main program areas: Education and Outreach, Enforcement, Public Policy Advocacy, and Research. The goals for each of these programs are as follows:

> *Education and Outreach*: To inform the general public, home-seekers (both renters and buyers), and housing providers of their fair housing rights and responsibilities.
>
> *Enforcement:* To assist home-seekers in pursuing individual complaints, to investigate and challenge systemic housing discrimination, and to enhance the region's enforcement capacity, through testing, technical assistance, and legal action.
>
> *Public Policy Advocacy:* To advocate for strong local, state, and federal housing laws and policies and ensure their effective implementation, in collaboration with other fair housing, legal, civil rights, and community groups.
>
> *Research:* To research and document the nature and extent of housing discrimination as well as the fair housing impacts of public policies in order to inform our education, enforcement, and policy activities.

The Fair Housing Center serves the communities of Norfolk, Suffolk, Essex, Middlesex, and Plymouth counties and seeks to promote fair housing for all protected classes under federal, state, and local laws. We partner with urban community organizations serving home seekers, suburban community organizations promoting diversity within their communities, and attorneys experienced in civil rights litigation. The Fair Housing Center works in close collaboration with other organizations to increase their fair housing expertise and enhance the capacity of organizations and communities to further the goal of making residential neighborhoods open, welcoming and accessible to all.

II. Summary of research on housing discrimination in greater Boston

Although the Boston metropolitan region, like many others in the nation, has undergone a degree of diversification in recent years, an analysis of the 2000 Census led the Harvard University Civil Rights Project to identify Boston as "the third 'whitest' of all large metropolitan areas – behind Pittsburgh and Minneapolis." According the report, the immigrant and non-white population remains concentrated within a "multi-ethnic core" in Boston, as well as "satellite cities surrounded by overwhelmingly white outer suburbs." (See 1, *Race, Place, and Opportunity*)

An earlier Harvard Civil Rights Project report, *Segregation in the Boston Metropolitan Area at the end of the 20th Century*, analyzed Home Mortgage Disclosure Act (HMDA) data

from 1993 to 1998 for the Boston metropolitan region and concluded: "The City of Boston is itself highly segregated and…this pattern of segregation is replicating itself across the cities and towns outside its boundaries." (See 2, *Segregation in the Boston Metropolitan Area at the end of the 20th Century*) The study found that a significant proportion of African American (40 percent) and Latino (60 percent) homebuyers made purchases outside the city of Boston (compared with 90 percent of European Americans). Though these data appear to suggest that people of color are migrating to the suburbs, nearly half of the purchases by African American and Latino buyers (48 percent) were concentrated in seven of the 126 communities included in the study (Chelsea, Randolph, Everett, Lynn, Somerville, Milton, Malden). Using a standard measure of residential segregation, the authors reported, "to achieve racial and ethnic integration with European-American homebuyers, over 50 percent of African American and Hispanic homebuyers would have had to have bought a home in a different city or town in the 1993 to 1998 period."

Some have tried to blame segregation on high housing costs. This trend is not new. In its 1998 *Analysis of Impediments to Fair Housing*, the state identified "the expense of housing" as a subtle but "most notable" condition impeding housing choice in both rental and sales markets (See 3, *Analysis of Impediments to Fair Housing*). "The high cost of housing limits housing choice and geographic mobility among lower income persons, including a disproportionate percentage of protected groups." In 2003, Fair Housing Center Director David Harris co-authored a study with Nancy McArdle of the Harvard Civil Rights Project to test the common explanation that people of color simply cannot afford to buy homes in our suburbs. The paper, "More than Money," analyzed census data on homeownership and HMDA data on recent mortgages to determine the extent to which the region's ongoing segregation can be explained by a disparity in the values/prices of homes people of color own and those owned by whites. In 80 percent of cities and towns, the number of African American and Latino homebuyers was less than half what would be predicted based on affordability alone. (See 4, *More than Money*). The study found that this simple notion of "affordability" does not explain the ongoing and frequently documented patterns of racial concentration and segregation.

We also know that the region has been characterized by troubling patterns of discrimination in the mortgage market. Indeed, a study published by the Federal Reserve Bank in 1992 showed that the serious disparities between the loan denial rates of borrowers of color

and white borrowers reflected racial discrimination by lenders as well as other factors (See 5, *Mortgage Lending in Boston: Interpreting HMDA Data*). This report, whose implications echoed across the country, was particularly alarming for a region characterized by racial strife and persistent segregation. The alarm led to several important initiatives to address the disparities, including the Massachusetts Bankers Association Fair Lending Initiative. Since the mid-1990s, the Massachusetts Community and Banking Council (MCBC), a coalition of banks and community groups, has published annual reports documenting disparities in the lending market. Based on Home Mortgage Disclosure Act (HMDA) data, the reports document differences by race in the proportion of loans received, denial rates, and lending to neighborhoods with high proportions of residents of color.[1]

The first series of MCBC reports, entitled *Changing Patterns (I-XII),* has shown consistently lower rates of lending to borrowers of color both in the city of Boston and throughout Greater Boston. Although there have been improvements in some areas over the twelve years documented by *Changing Patterns*, lending to borrowers of color continues to lag behind lending to whites and in recent years there has been an increase in the ratio of loans denied to borrowers of color compared with white borrowers. Indeed, the most recent reports have shown the denial ratio for people of color actually increases as income rises (see 6, *Changing Patterns*). The second series of studies, *Borrowing Trouble (I-VI)*, looks specifically at the rapidly growing sub-prime lending market. Again, the studies document that a disproportionately large percentage of these high costs loans go to African Americans and Latinos, even to those with higher incomes. Moreover, the pattern spilled over into neighborhoods, with sub-prime lending rising in neighborhoods containing larger populations of color and the same trends occurring in suburban communities and satellite cities as in the city of Boston itself (see 7, *Borrowing Trouble*).

The recent trends in mortgage lending caused significant enough concern that in May 2004 MCBC sponsored a forum to address the issue. Bankers suggest that their "second look" programs and other practices successfully eliminate discrimination from the decision-making

[1] MCBC was founded by bankers and community groups "to increase the provision of credit and banking services to the low-income and minority communities within the city of Boston." The impetus for its founding was the widely publicized 1989 Federal Reserve study that found large disparities in lending to people and communities of color. Fair Housing Center Director David Harris is Vice Chair of the board of MCBC and its mortgage lending reports are written by Fair Housing Center Board Chair Jim Campen.

process and point to problems with the credit histories of borrowers. Many community groups and housing advocates, however, suspect that lenders continue to use discriminatory practices and that practices such as credit scoring and desktop underwriting might have discriminatory effects. These lending issues are of particular concern in a region characterized by ongoing segregation, exorbitant housing prices and below national average homeownership rates for African American and Latino families.

As much as we know about the differences in housing outcomes between people of color and whites in the region, we have scant data on causes. Over the past five years this gap has been filled by testing audits conducted by the Fair Housing Center. In April 2001 the Fair Housing Center released *We don't want your kind living here,* its first study reporting testing for discrimination in the rental market based on race, family status (the presence of children), and source of income (receipt of Section 8 housing subsidy). The audit results revealed that 55 – 67 percent of the protected class testers experienced some form of discrimination. The following year the Fair Housing Center conducted an audit of discrimination against Latino home seekers in the area's rental market. The findings confirmed evidence of discrimination against Latino home seekers in 52 percent of the tests conducted. In some 40 percent of the cases, Latino home-seekers were less likely to have access to agents and access to view units than white testers. This audit was followed in 2004 by an audit by race and national origin of the rental market in greater Lowell and the Merrimack Valley which found that of 66 total tests, 47 percent showed evidence of discrimination, with Latinos experiencing the highest incidence.

The Fair Housing Center has also investigated the home purchase market. Between January 2004 and May 2005, the Fair Housing Center conducted two series of tests to determine the extent and nature of discrimination against African American and Latino homebuyers in greater Boston. The Fair Housing Center used trained volunteers to call and visit real estate offices of large chain realtors in fourteen cities and towns across the greater Boston region. Overall, the Fair Housing Center found a pattern of differences in treatment that disadvantaged homebuyers of color in 17 of the 36 matched paired tests (47 percent). White testers were given more information, were provided greater access to the realtors, and shown more homes in more towns. Realtors shared more information with white testers posing as homebuyers, noting when the sellers were motivated or had dropped the price. Realtors pursued white testers via phone

and e-mail to become their buyer's agent, but made no such pursuit of more qualified testers of color. Instead, testers of color were plied with more questions about their qualifications.

One of the most consistent aspects of all these tests was that there was not one single instance in which a tester of color was subjected to overt discrimination. This simple fact underscores the need for and benefit of testing as a means of gauging discrimination in general, but particularly in a lending industry characterized by such large differences in outcomes.

III. Applicable laws

Housing discrimination is defined largely by the Fair Housing Act of 1968 (Title VIII) and the Fair Housing Act Amendments of 1988 (42 USC § 3601 et seq.). According to the law, it is illegal to discriminate against someone because of his or her race or color, national origin, sex, religion, familial status (families with children) and disability. In Massachusetts, as in many other states, housing discrimination is also prohibited under state law. Chapter 151b of the Massachusetts General Laws largely mirrors the federal law, but adds marital status, sexual orientation, veteran status, age, and source of income (receiving public assistance and/or having a housing subsidy) to the list of protected classes.

According to the law, housing providers are prohibited from numerous actions because of a person's membership in a protected class, including denying or making different terms or conditions for a mortgage, home loan, homeowner's insurance or other real estate related transaction. In addition to the coverage provided by fair housing laws, mortgage lending is covered by the Equal Credit Opportunity Act, which prohibits discrimination in "any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age or public assistance income."

IV. Methodology

This mortgage lending audit is a systematic investigation of the mortgage lending market for the purpose of gauging the prevalence and types of discrimination present. In order to address housing discrimination in the Greater Boston region, both in terms of education and enforcement, we need an accurate picture of how it occurs, and who it affects. The testing audit has been proven to be one of the most effective tools for providing hard numbers about discrimination and a basis for remedial action.

Testing

Testing is a controlled method of measuring and documenting variations in the quality, quantity and content of information and services offered or given to various home seekers by housing providers. Quite simply, a test is designed to reveal differences in treatment and to isolate the causes of these differences. A proven tool for discovering the presence of discrimination, testing has become a common and accepted practice in several arenas. Additionally, testing is used to determine whether or not there is evidence to support or deny an individual's claim of discrimination. The legitimacy of testing evidence in housing discrimination cases has long been upheld by the courts. In several cases, including *Strong V. Chatsford Manor Apartments*, *Havens Realty Corporation v. Coleman*, and *City of Chicago v. Matchmaker Real Estate*, courts all the way up to the Supreme Court have accepted testing evidence as useful and valid evidence in support of a plaintiff's claim of discrimination.

Fair Housing Center staff members provide all testers with standardized training that emphasizes the role of testers as objective fact finders. Volunteer testers are trained to provide an impartial record of the facts of their interactions with a housing provider. Testers for this audit had previous experience as rental testers and received additional training in mortgage lending testing. The Fair Housing Center's Test Coordinator pairs testers and assigns both members of the pair near-identical incomes, credit ratings, and housing search locations, so that the only major difference between the paired testers is the characteristic being tested.

In this investigation, the variable characteristic was the race or ethnicity of the loan seeker. To ensure the objectivity of the test results, testers are not told what form of discrimination they are testing. Each tester separately calls or visits a lender and records his or her experience. Testers complete detailed written narratives documenting their experiences and debrief orally with the Fair Housing Center's Test Coordinator. The Test Coordinator then compares the documented experiences of each tester in the pair to determine whether or not there were differences in the treatment, or in the information and/or service provided. In tests where the Test Coordinator finds differences, Fair Housing Center staff review and analyze these differences to determine whether or not the differences may violate of federal or state law.

Selection of Sites

Fair Housing Center staff met several times with staff of the Massachusetts Affordable Housing Alliance (MAHA) to discuss selection of sites and test methodology. MAHA provided the Fair Housing Center with the names of the 25 mortgage lenders who do the highest volume of lending in Boston. To this list, the Fair Housing Center added several companies who do a high volume of business in greater Boston and are reputed to have very low customer satisfaction rates. From this list, the Fair Housing Center tested ten banks and ten mortgage lending companies with offices located throughout Greater Boston.

Test Design

The Fair Housing Center conducted twenty matched pair site visit tests for discrimination against African-American, Latino, Asian, Caribbean loan seekers. The audit was designed for each tester to have similar experiences, with every effort to have testers contact the same person. During each test, the testers requested that the mortgage provider give them any information or quotes available but were instructed not to pursue the full application process.

In MAHA's experience, homebuyers of color with mediocre credit are often turned away by mortgage providers, while the companies attempt to work with white homebuyers with similar credit to find ways to provide the loans. The Fair Housing Center sought to gather evidence as to whether such differences are occurring and therefore decided to include two levels of credit ratings. Ten pairs of testers had good credit, with credit scores of approximately 750. Ten pairs of testers had mediocre credit, with credit scores of approximately 650. The tester of color was assigned a credit score 30 points higher, a higher income and somewhat less debt than the white tester. All testers inquired about a $475,000 mortgage with $25,000 down payment.

V. Findings

Overall, the Fair Housing Fair Housing Center found differences in treatment that disadvantaged homebuyers of color in nine of the twenty matched pair tests. In seven of these tests the differences in treatment were clearly large enough to form the basis for legal action, while the evidence in the remaining two tests may or may not have risen to that level. The chart below breaks down these test results by several different variables.

	Tests Conducted	Tests Showing Evidence of Discrimination	Percent of Tests that Show Evidence of Discrimination
All tests	20	9	45%
Good Credit	10	4	40%
Mediocre Credit	10	5	50%
African American/White pair	10	5	50%
Asian/White pair	4	2	50%
Latino/White pair	5	2	40%
Caribbean/White pair	1	0	0%

Four of the tests with differences in treatment were conducted by pairs of testers with good credit scores, and five were done by pairs with mediocre credit scores. Of the ten tests pairing white and African American testers, there were five test pairs where the African American tester received disadvantageous treatment. Of the four Asian tests pairing with white tester, two showed evidence of discrimination. There were five tests pairing Latino and white testers, and in two the lender advantaged the white tester over the Latino tester. The one test pairing a Caribbean and white tester did not show evidence of discrimination.

Summaries of the nine tests with differences are detailed here:

An African American tester with a good credit score of 670 visited a bank to inquire about a mortgage. She was told that the closing fee would be $8,000 to $9,000, although other tests in this investigation indicated that average closing fee was $2,000-$3,000. The bank representative also told her that her credit score of 670 was below average; other tests indicated that credit score of 670 was well above average. Finally, the bank representative told her that the bank usually dealt with commercial lending, and did not really provide residential mortgages. In contrast, the white tester with a credit score of 640 who visited the same bank was told by two different loan officers that the bank provided home mortgage loans, and was not told that her credit score was below average.

An Asian American tester with credit score of 770 and a white tester with credit score of 740 visited a mortgage lending company. The Asian American tester received a referral to a realtor to help her find a home. The white tester was told about two realtors who in could provide her with discounts on fees as well as help her find a home. The white tester also received a $500 certificate towards closing fees; the Asian American tester received no certificate or offer of a discount.

A Latino tester with a credit score of 670 and a white tester with a credit score of 640 visited a mortgage lending company. The lender provided both with quotes on monthly payments, and the Latino loan seeker's quote was $254 per month more than the white loan seeker was told for a 30 year fixed loan, and $140 per month more for a blended loan[2]. The lender also told the Latino loan seeker that she would need private mortgage insurance (PMI), which would cost $309 per month. The lender did not bring up PMI to the white loan seeker. The lender did tell the white loan seeker about how to get a better loan product when your credit score is under 680, but did not discuss this with the Latino loan seeker, whose score was also below 680. Finally, the white loan seeker was given informational literature about different loan products and loan process, and received a follow up email from the lender. The Latino loan seeker did not receive any literature or follow up email.

An African American tester with a credit score of 770 and a white tester with a credit score of 740 inquired at a mortgage lending company. The lender gave the white homebuyer an explanation of six different types of mortgage loans, naming advantages and disadvantages of each. The white homebuyer asked about getting a blended loan to avoid PMI, and the lender replied that the second loan in the two-loan "blended loan" has high interest, so a blended loan is a bad idea. At the end of the meeting, the lender asked the white homebuyer for her address so that he could send a thank-you card. When the African American homebuyer visited, she was told about one loan product only: the blended loan. The lender did not mention the high interest on the second loan or any other loan products.

An African American tester with a credit score of 770 and a white tester with a credit score of 740 visited a bank. Their visits to the lender were comparable, but after the visit, only

[2] A blended loan is a mortgage product that consists of two parts, usually with different rates for different periods of time (with the second loan for a smaller amount at a higher rate). In this instance the blended loan was composed of a 30 year fixed for the first loan and 10 year fixed for the second loan.

the white tester received a follow up email with more information about different loan products and a $500 certificate toward the closing fee. The African American tester did not receive follow up contact or the $500 offer.

An Asian American tester with a credit score of 770 and a white tester with a credit score of 740 inquired at a bank. The lender recommended a 30 year fixed loan with 0.75 points to the Asian American, quoting a monthly payment of $3,350, not including tax and insurance. To the white home seeker, the lender recommended five year ARM with no points, with a monthly payment of $3,225, including tax and insurance. This means that the Asian American home seeker was quoted approximately $3,600 more for the closing fee because of the point and $125 plus tax and insurance per month more than her white counterpart. The lender told the white home seeker that an ARM was better choice than a 30 year fixed rate because most people who buy homes in the town she was considering refinance within five years. The Asian American home seeker was looking to buy a home in the same town. The lender gave the white home seeker numerous information sheets, including brochures about different types of loans, an ARM loan procedure worksheet, 2006 property tax information, and a pre-approval guidebook. The lender did not give any information sheets to the Asian American. While it is impossible to know exactly what product would have been better for either home seeker, the lender characterized the ARM a better choice by giving the white person an explanation and explanatory material while providing the person of color with neither to explain his recommendation for a fixed rate mortgage.

An African American tester with a credit score of 670 and a white tester with a credit score of 640 were sent to a bank without a prior appointment and inquired about mortgage products. The loan officer referred the African American tester to another loan specialist at a different branch without giving her any information about loan products. The African American tester had to make an appointment with the second officer and then meet with him to get information about loans. The white tester walked in to the same initial branch and the same lender met with the white tester on the spot and discussed loan products, rather than referring her to a different branch. The lender told the white tester that borrowers receive a $2,000 credit toward the closing fee if the borrower has an account with the bank. While the loan officer encouraged the African American tester to open an account to receive a discount on closing, he

did not tell the tester how large the discount was. Lastly, the lender sent a follow up email to the white tester explaining all the loan products this bank offered and their rates and estimated monthly payments. The African American tester was not asked for her email address and received no follow up information.

An African American tester with a credit score of 670 and a white tester with a credit score of 640 visited a mortgage lending company. The lender provided informational pamphlets about mortgages to the white tester, but not the African American tester.

A Latino tester with a credit score of 670 and a white tester with a credit score of 640 inquired at a bank. Both were told about 30 year fixed and unspecified blended loans (that is, the lender did not tell either tester the specific terms of the blend), but the white home seeker was also told about an ARM loan. The white home seeker was encouraged to submit an application as soon as possible, while the lender did not talk about applying with the Latino home seeker. The white home seeker was given pamphlets about different mortgages, a guidebook about mortgages, a worksheet for the cost of mortgage, and an application; the Latino home seeker received none of these materials.

VI. Discussion and Commentary

The results of this investigation are disturbing and reveal inconsistencies in the treatment of and services provided to testers of color when compared directly to white loan seekers. These differences serve to disadvantage loan seekers of color and advantage white loan seekers. The testing process directly reflects reality insofar as neither testers of color nor white testers were aware of their relative (dis)advantages. As in previous Fair Housing Center audits, no individuals were targets of outright hostility or subjected to overt discrimination. Many of the incidents of possible discrimination involved discouraging statements, higher quotes, or worse treatment of the tester of color or encouraging statements, lower quotes, or better treatment for the white tester.

The most troubling finding of this investigation is that discriminatory behavior takes place from the very beginning of and can continue at many points throughout the lending process. All the tests were pre-application phase but loan seekers of color were still disadvantaged in 45 percent of the tests. This investigation suggests that many borrowers are

subjected to discrimination from the beginning of their lending process, but do not realize it. There is reason to believe, from other sources, that discrimination also happens at later stages of securing a mortgage loan. Common reports of "bait and switch" tactics suggest that borrowers who initially receive good treatment and attractive terms from the lenders will receive different terms at or near their closing. According to MAHA, many of their clients, most of whom are African American, experience just such treatment toward the end of the loan process.

Our investigation shows that lenders frequently give white loan seekers more information than loan seekers of color, creating a gap between white people's financial literacy and that of people of color. In seven of the twenty tests conducted in this investigation, the white loan seeker received substantially more information from the lender about different types of loans, either verbally or in writing (and often both), than the loan seeker of color, and not once did the person of color receive more information than his or her white counterpart. When a lender takes the time to describe the advantages and disadvantages of different loans, the loan seeker becomes an educated consumer. That loan seeker is now equipped with knowledge that will allow him or her to choose the right loan type and negotiate with lenders in the future. In contrast, when a lender simply tells a loan seeker "this is the loan for you, and it costs this much," the loan seeker has not gained any insight into how to choose the right loan or get a good interest rate. Our investigation shows that it is not just the lender's style that determines how much information a home seeker receives, in too many cases it is the color of the loan seeker's skin.

In four out of twenty tests, the lender contacted the white tester after their meeting to follow up, but did not contact the tester of color. Follow up comes in different forms, including additional information about loan products, a suggestion to pursue a loan with that lender, or a simple thank you card for the meeting. All of these sorts of contact send a message that the lender wants the loan seeker as a client. No lender in our study followed up with the tester of color and not with the white tester.

In five out of twenty tests, the white tester was offered a discount on closing costs which was not offered to the tester of color, or was quoted a substantially lower closing cost than the tester of color. The differences ranged from $500 to $3,600. We cannot assume that these preliminary numbers accurately reflect the final closing costs had our testers truly applied for a loan. However, at the first stages of shopping for a mortgage, quotes with high closing costs can

discourage home seekers of color from pursuing home ownership at all. And lenders know that closing costs are a big factor in consumers' choice of lenders; that is why they offer specials like certificates for money off closing fees. If such specials are made available to white loan seekers but not loan seekers of color, the lender is pursuing white customers while allowing non-white potential customers to walk away.

As detailed above, testers posing as loan seekers were frequently subjected to more than one difference in treatment. If a loan seeker cannot detect these differences and avoid a lender who disadvantages mortgage seekers of color, he or she may end up paying much more for a loan. When people of color must pay substantially more per month than a similarly situated white people, these costs perpetuate the wealth gap between white people and people of color, despite the rising incomes and rates of homeownership among people of color. Greater awareness and vigilance for signs of discrimination in the early stages of applying for a mortgage may even help the borrower avoid lenders who discriminate, so that the borrower is not stuck with a discriminatory change in loan terms right before closing, when it is impractical to change to a different lender.

VII. Recommendations

Over the past few years the Fair Housing Center of Greater Boston has conducted several sales and rental housing discrimination audits. In all of those encounters there has never been a single example of overt racial hostility. Even so, past audits have found discrimination to be the norm rather than the exception- home seekers of color can expect to experience discrimination in just over half of their attempts to rent or purchase housing in greater Boston. The results of this study of mortgage lending companies and banks sadly follows this pattern, with borrowers of color can facing discrimination in nearly half of their contacts with mortgage lending agents. We offer the following limited recommendations in the hope of working with the industry to eradicate discriminatory practices in the mortgage lending market.

1. The frequency and subtlety of the discriminatory practices revealed during the Fair Housing Center's mortgage lending audit underscore the need for ongoing systemic and complaint-based discrimination testing.

2. There is an obvious and glaring need for comprehensive fair lending policies to ensure that all members of the mortgage lending industry, including institutions and all individuals involved in the process, have clear cut guidelines and responsibilities consistent with fair housing laws and established best practices.

3. Lending institutions should review their internal training programs and make sure that the policies adopted and implemented are routinely reinforced for all agency personnel.

4. The subtlety of discriminatory practices revealed by the audit underscores the need for extensive outreach and education for home seekers about their rights under the fair housing laws and the resources available to secure those rights.

5. The various existing enforcement agencies - Federal, state and local -- must vigorously enforce the fair lending laws. They must complete investigations of valid complaints in a timely and efficient manner. These enforcement agencies must be allocated sufficient funds to carry out this work.

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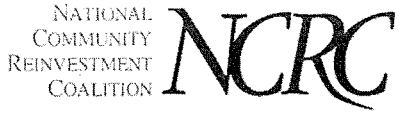


June 12, 2006

Chairman Spencer Bachus and Ranking Minority Member Bernard Sanders
Financial Institutions and Consumer Credit Subcommittee
House Committee on Financial Services
2128 Rayburn House Office Building
Washington DC 20515

Dear Chairman Bachus and Ranking Minority Member Sanders:

The National Community Reinvestment Coalition (NCRC), the nation's economic justice trade association of 600 community organizations, appreciate that you are holding the hearing, "Home Mortgage Disclosure Act: Newly Collected Data and What It Means." Your leadership will help policymakers and the general public understand how the new HMDA data are key to building wealth through increases in homeownership.

NCRC would like to submit for the hearing record the following three studies we conducted and that are relevant for your hearing:

1) *Homeownership and Wealth Impeded – Continuing Disparities for Minorities and Emerging Obstacles for Middle-Income and Female Borrowers of all Races*

2) *The 2005 Fair Lending Disparities: Stubborn and Persistent II*

3) *The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age*

As demonstrated in NCRC's reports, the new HMDA pricing data enhances the abilities of regulatory agencies, community organizations, and lenders in determining whether significant pricing disparities by race and gender reflect possible discriminatory lending patterns. NCRC's *Homeownership and Wealth Impeded* report uses the 2004 HMDA data to examine in detail pricing disparities by race and gender when controlling for income levels.

The report uncovers troubling evidence that racial disparities increase when income levels increase. For example, subprime loans made up a high 41.9 percent of all refinance loans to low- and moderate-income (LMI) African-Americans. In contrast, subprime loans were 19.2 percent of refinance loans to LMI whites in 2004. LMI African-Americans were 2.2 times more likely than LMI whites to receive subprime loans. Even for middle- and upper-income (MUI) African-Americans, subprime loans made up a large percentage (30.2 percent) of all refinance loans. Moreover, the subprime share of loans to MUI African-Americans was 2.7 times larger than the subprime share of loans to MUI whites. The same pattern of disparities increasing with income occurred when the report examined lending to females compared to males or in immigrant neighborhoods compared to predominantly white neighborhoods.

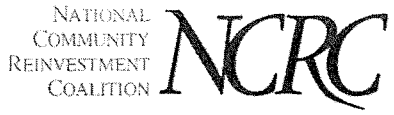
NCRC's report, the *2005 Fair Lending Disparities: Stubborn and Persistent II* is one of the first reports conducted with the new 2005 HMDA data. The study uses data collected from 17 large lenders. The study finds a large surge in high-cost lending from about 12.2 percent of all loans in 2004 to 28.2 percent of all loans in 2005. Much has already been written about the flattening yield curve accounting for a substantial portion of the increase in high-cost lending in 2005. Economists themselves differ regarding whether the 2005 data capture a larger portion than the 2004 data of subprime lending or the more expensive segment of prime loans. The general public will receive more information about the reasons for the surge in high-cost lending when the Federal Reserve conducts and releases its own analysis in September of 2006.

What is clear from the NCRC study is that even middle-income borrowers are now receiving a substantial portion of high-cost loans; 40 percent of the loans made to middle-income borrowers were high-cost loans in NCRC's 2005 sample. In addition, disparities by race and gender remain stubborn and persistent. The facts that lending disparities remain significant by race and gender and impact a significant segment of middle-income Americans suggest that fairness in the lending marketplace is now a pressing issue for a broad segment of Americans.

Finally, NCRC's the *Broken Credit System* report found that after controlling for creditworthiness, high-cost lending still increased in minority neighborhoods and in neighborhoods with considerable numbers of elderly residents. Federal Reserve economists have come to similar conclusions as well. The Center for Responsible Lending just recently used the 2004 HMDA data with pricing information to also reach the same troubling conclusions that racial disparities remain after controlling for creditworthiness.

All stakeholders acknowledge that the new HMDA data does not contain all the elements needed to prove or disprove the existence of discrimination. But the new HMDA data reveals substantial disparities that do not go away when the HMDA data is combined with creditworthiness data. These findings suggest the need to further enhance HMDA data with additional data such as creditworthiness as well as loan-to-value and debt-to-income ratios. While the new HMDA data is very useful as an indicator of potential discrimination, it would be most useful in achieving its statutory purpose of identifying possible discrimination if it had more data elements. NCRC hopes that all stakeholders work together in figuring out how the HMDA data can be further enhanced and made more powerful.

In the meantime, NCRC uses HMDA data not only to identify possible discriminatory patterns but to achieve the other statutory purposes of HMDA. These purposes include determining whether financial institutions are serving the housing needs of their communities and in assisting public officials in distributing public-sector investments so as to attract private investment to geographical areas where it is needed.



NCRC has recently conducted studies sponsored by the City of Philadelphia and Cincinnati to assist those municipalities in assessing the extent to which credit needs are being met. The studies identified areas of significant progress such as healthy increases in prime home purchase lending to minorities and low- and moderate-income borrowers in Philadelphia. In addition, the studies suggested that stakeholders needed to address some significant credit needs such as increasing low levels of home improvement lending in Cincinnati, a city with an aging housing stock. In Philadelphia, private sector lending has not yet caught up with public sector investment in neighborhoods targeted by Empowerment Zones and other revitalization initiatives.

In sum, NCRC believes that data drives the movement for economic justice and makes capitalism work in all communities. Without HMDA data, stakeholders could not assess the extent to which credit needs are being met and whether discrimination, market failure, and/or other barriers were impeding the flow of credit to traditionally underserved populations.

We hope that the subcommittee has a productive hearing investigating the value of HMDA and how the data can be enhanced. We also hope the hearing asks probing questions about the status of fair lending enforcement. How can it be possible that the Federal Reserve referred 200 lenders making about half the loans in the industry to their primary regulators for additional investigations but that not one fair lending enforcement case has been concluded almost one year later?

Thank you for this opportunity to submit NCRC's reports to the hearing record. Please feel free to contact me or Josh Silver, Vice President of Research and Policy, for more information.

Sincerely,

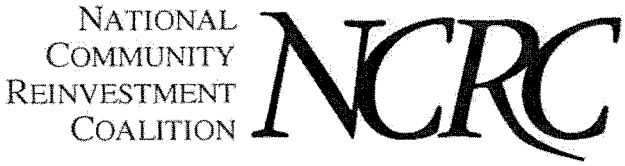
John Taylor
President and CEO

CC: NCRC Board of Directors and Membership

Homeownership and Wealth Building Impeded

Continuing Lending Disparities for Minorities and Emerging Obstacles for Middle-Income and Female Borrowers of All Races

April 2006



PRRAC

Poverty & Race Research Action Council

Acknowledgements

The National Community Reinvestment Coalition

The National Community Reinvestment Coalition (NCRC) is the nation's trade association for economic justice whose members consist of local community based organizations. Since its inception in 1990, NCRC has spearheaded the economic justice movement. NCRC's mission is to build wealth in traditionally underserved communities and bring low- and moderate-income populations across the country into the financial mainstream. NCRC members have constituents in every state in America, in both rural and urban areas. The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication including John Taylor, David Berenbaum, Joshua Silver, Noelle Melton, Tim Westrich, and Anna Gullickson. NCRC conducted the data analysis and was the lead author for this report.

NCRC: www.ncrc.org, (202) 628-8866

The Opportunity Agenda

The Opportunity Agenda is a communications, research, and advocacy organization dedicated to building the national will to expand opportunity in America. This report stems from research conducted for The Opportunity Agenda and PRRAC as part of the Opportunity Agenda's inaugural report, *The State of Opportunity in America* (2006).

The Opportunity Agenda: www.opportunityagenda.org, (212) 334-5977

Poverty & Race Research Action Council (PRRAC)

The Poverty & Race Research Action Council (PRRAC) is a civil rights research and policy organization based in Washington, D.C. PRRAC's primary mission is to help connect advocates with social scientists working on race and poverty issues, and to promote a research-based advocacy strategy on race and poverty issues.

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We also wish to thank Professor Gregory D. Squires, Chairman of the Sociology Department at George Washington University for his edits and comments. Professor Squires is a member of PRRAC's Social Science Advisory Board.

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Executive Summary

Using the home loan data available for the year 2004, this study reveals persistent fair lending disparities for minorities and emerging obstacles for middle-income and female borrowers of all racial groups. Fair access to affordable loans has not been achieved for minorities. Instead, minorities continue to receive a disproportionate number of high cost home loans. In addition, the study reveals that middle-income and female borrowers of all racial groups have difficulties securing affordable home loans and receive a surprisingly high number of high cost loans. The unequal access to affordable loans also confronts middle-income borrowers who reside in minority neighborhoods or communities with large numbers of immigrants.

The abilities of a broad segment of the American population to build wealth through homeownership are impeded by the prevalence of high cost lending that drains homeowner equity. Indeed, building wealth through homeownership has been the American Dream and the path to opportunity for Americans for generations. Stakeholders need to come together to make sure that wealth-building opportunities are preserved by increasing equal access and fairness in the lending marketplace.

This study breaks new ground in a number of areas. While previous studies focus on lending trends by race, this study explores the intersections among race, gender, and income. That is, controlling for gender and income, the study reveals that minorities were still more likely to receive high cost loans than whites. Conversely, controlling for income and race, the study shows that females were still more likely than whites to obtain high cost loans than males. Finally, the study probes new areas by assessing lending patterns in minority and immigrant neighborhoods. No previous study to our knowledge has specifically examined lending in immigrant neighborhoods. In minority and immigrant neighborhoods, lending disparities increased as borrower income levels increase.

The analysis explores trends in prime and subprime lending. Prime loans are loans offered at competitive interest rates while subprime loans are high cost loans offered at higher interest rates. Higher interest rates can compensate subprime lenders for making loans to borrowers with credit imperfections. Responsible subprime lenders play an important role in making loans available to credit impaired borrowers who may not otherwise receive loans.

Public policy concerns arise, however, if particular demographic groups of borrowers receive a large number of subprime loans. In these instances, it is possible that a significant part of the demographic group has good enough credit for prime loans. If the marketplace can be made more competitive, all of the creditworthy borrowers of the particular demographic group would receive prime loans. This would improve the wealth building prospects of the demographic group since subprime loans are tens or hundreds of thousands of dollars more expensive than prime loans. Most Americans build wealth through homeownership, and affordable loans improve the abilities of borrowers to build home equity.

The 2004 Home Mortgage Disclosure Act (HMDA) data, released in the fall of 2005, improves the quality of data analysis by providing pricing information with more precision than data from earlier years. Pricing information that indicates whether a loan is prime or subprime is available on a per loan basis. In previous years, researchers relied on a list of subprime lending specialists generated by the Department of Housing and Urban Development (HUD). The list was widely used and respected, but its limitation was that it could only reveal lending patterns of subprime lenders, as a group. Until the 2004 HMDA data, no pricing information was available on a per loan basis. This per loan pricing information sharpens the quality and accuracy of data analysis.[1]

Using the 2004 data, this study found a disproportionate amount of subprime lending to minorities, women, low- and moderate-income borrowers, and borrowers in working class and minority neighborhoods. But even middle-income borrowers, particularly middle-income minorities and women, experienced disparities in lending.

The following data illustrate the familiar and new disparities in lending revealed by the analysis:

- African-Americans did not receive prime loans in proportion to their population but received a disproportionate amount of subprime loans. African-Americans were about 11.8 percent of the nation's households but received just 5.5 percent of the conventional prime home purchase loans and 20.1 percent of the subprime purchase loans issued during 2004 (see Appendix, Table 1A and Graph 1, page 8). Hispanics received a share of prime purchase loans (11.4 percent) slightly higher than their share of the nation's households (9.1 percent), but were issued 21.3 percent of the subprime home purchase loans. These differences could be explained, in part, but not completely by income differences among various racial groups.

- In fact, racial disparities in the share of borrowers receiving subprime loans were greater for upper-income borrowers than lower-income borrowers. Subprime loans made up a high 41.9 percent of all refinance loans to low- and moderate-income (LMI) African-Americans (see Table 2B). In contrast, subprime loans were 19.2 percent of refinance loans to LMI whites in 2004. LMI African-Americans were 2.2 times more likely than LMI whites to receive subprime loans. Even for middle- and upper-income (MUI) African-Americans, subprime loans made up a large percentage (30.2 percent) of all refinance loans. Moreover, the

[1] The Federal Financial Institutions Examination Council considers a first lien loan as high cost if the spread between the APR on the loan and Treasury securities of comparable maturities is 3 percentage points or higher. A second lien is considered as high cost if the spread between the APR on the loan and Treasury securities of comparable maturities is 5 percentage points or greater. The Federal Reserve Board states that the vast majority of subprime loans were captured by the price reported loans for 2004. For this report, loans with price reporting are considered subprime. Regarding HUD's lists of subprime specialists, HUD's web page (http://www.huduser.org/datasets/manu.html) has more information about the lists and has copies of the lists.

subprime share of loans to MUI African-Americans was 2.7 times larger than the subprime share of loans to MUI whites (see Graph 17, page 28).

- Females of all racial groups also received a disproportionate share of subprime loans relative to prime loans. Females constituted 29 percent of the nation's households but obtained just 24 percent of all prime home purchase loans and 32.1 percent of the subprime loans (see Table 1A and Graph 8, page 13). In contrast, males received a share of prime loans (31.9 percent) that was higher than their share of the nation's households (18.4 percent of households were headed by males only).

- Even middle-income borrowers of all racial groups obtained a disproportionate amount of subprime loans. Middle-income borrowers were 19.2 percent of the nation's households but obtained 30.8 percent of the subprime home purchase loans during 2004 (see Table 1A and Graph 5, page 11). In contrast, upper-income borrowers were 41.2 percent of the nation's households and received 30.9 percent of the subprime loans but 48.2 percent of the prime loans during 2004.

- Within races, the disparity in subprime shares of loans to females relative to males widened as income level increased. For example, subprime loans were 7.6 percent and 6.4 percent of the home purchase loans to LMI female and male Asians, respectively (see Table 3A). Consequently, LMI female Asians were 1.2 times more likely than LMI Asian males to receive subprime loans. In contrast, MUI female Asians were 1.5 times more likely than MUI male Asians to receive subprime loans (see Graph 18, page 30). Subprime loans constituted 7.2 percent of the loans to MUI female Asians but just 4.9 percent to MUI male Asians.

- Lending disparities also increased between immigrant and white neighborhoods as income level of borrowers increased. Subprime lending accounted for 13 percent of the home purchase loans to LMI borrowers in neighborhoods in which more than 50 percent of the residents are foreign born (immigrant neighborhoods) (see Table 4A). Subprime loans were a higher share of loans (15 percent) to LMI borrowers in white neighborhoods. In contrast, subprime loans made up 13.6 percent of the loans to MUI borrowers in immigrant neighborhoods but just 8.3 percent of the home purchase loans to MUI borrowers in white neighborhoods during 2004. Minority neighborhoods (more than 50 percent of the residents are racial or ethnic minorities) also experienced greater disparities in lending than white neighborhoods as income levels of borrowers increased (see Graph 16, page 27).

The analysis also considered trends in home improvement, government-insured, manufactured home lending, and second lien lending. Home improvement lending was a much smaller volume than home purchase and refinance lending, but subprime loans made up a higher portion of home improvement loans than home purchase or refinance loans. Government-insured lending included relatively little subprime lending and generally resulted in lower disparities by race and income. Manufactured home lending

was more focused to low- and moderate-income borrowers than minorities. Finally, second lien lending was oriented more towards whites and affluent borrowers than first lien lending.

Significant lending disparities confront America. Lending disparities by race are too familiar, and also stubborn and persistent. Lower income borrowers also receive higher portions of subprime loans than prime loans. Yet, this report sheds additional light on lending disparities by illustrating that many middle-income Americans (particularly middle-income women and minorities) are encountering less access to prime loans than would be expected. Addressing lending disparities is not just a concern for minority and lower income Americans. Women and middle-income Americans of all racial groups should also be engaged in this effort. Wealth building through affordable homeownership will only be fully realized if lending disparities are further reduced for a broad segment of Americans.

The next sections of the report include a brief literature review and introduction, a detailed report on the results of the data analysis, and recommendations.

Literature Review and Introduction

A substantial body of research documents significant disparities in loan pricing based on the race, age, and income levels of neighborhood residents. These disparities are due to a combination of discrimination, market failure, and a variety of other factors in minority and working class neighborhoods. Discrimination and market failure impedes wealth building and the creation of sustainable homeownership opportunities for residents of traditionally underserved neighborhoods.

Significant disparities in loan pricing reflect the growth of subprime lending. A subprime loan has an interest rate higher than prevailing and competitive rates in order to compensate for the added risk of lending to a borrower with impaired credit. NCRC defines a predatory loan as an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers. Predatory loans are a subset of subprime loans. A predatory loan has one or more of the following features: 1) charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections, 2) contains abusive terms and conditions that trap borrowers and lead to increased indebtedness, 3) does not take into account the borrower's ability to repay the loan, and 4) violates fair lending laws by targeting women, minorities and communities of color.

Lending discrimination in the form of steering high cost loans to underserved borrowers qualified for market rate loans results in equity stripping and has contributed to inequalities in wealth. According to the Federal Reserve Survey of Consumer Finances, the median value of financial assets was $38,500 for whites, but only $7,200 for minorities in 2001. Whites have more than five times the dollar amount of financial

assets than minorities. Likewise the median home value for whites was $130,000 and only $92,000 for minorities in 2001.[2]

Since subprime loans often cost $50,000 to $100,000 more than comparable prime loans, a neighborhood receiving a disproportionate number of subprime loans loses a significant amount of equity and wealth. Using a mortgage calculator from Bankrate.com, a $140,000 30-year mortgage with a prime rate of 6.25% costs about $862 a month, or about $310,320 over the life of the loan. In contrast, a 30-year subprime loan with an interest rate of 8.25% costs $1,052 a month or approximately $378,637 over the life of the loan. The difference in total costs between the 6.25% and 8.25% loan is $68,317. Finally, a 30-year subprime loan at 9.25% costs $1,152 per month and $414,630 over the life of the loan. The difference in total costs between a 6.25% and 9.25% loan is $104,310. For a family who is creditworthy for a prime loan but receives a subprime loan, the total loss in equity can be easily between $50,000 and $100,000. This amount represents resources that could have been used to send children to college or start a small business. Instead of building family wealth, the equity was transferred from the family to the lender.

Building upon this example, the equity drain from a neighborhood can be tremendous. Suppose 15 percent or 300 families in a predominantly minority census tract with 2,000 households receive subprime loans although they were creditworthy for prime loans (15 percent of families that are inappropriately steered into subprime loans is a realistic figure based on existing research). Further, assume that these families pay $50,000 more over the life of the loan than they should (the $50,000 figure is conservative based on the calculations immediately above). In total, the 300 families in the minority census tract have paid lenders $15 million more than they would have if they had received prime loans for which they could have qualified. The $15 million in purchasing power could have supported stores in the neighborhood, economic development in the neighborhood, or other wealth building endeavors for the families and neighborhood. For even one neighborhood, the magnitude of wealth loss due to pricing disparities and/or discrimination is stark. Across the country, the wealth loss is staggering and tragic.

In the *Broken Credit System* study released in early 2004, NCRC selected ten large metropolitan areas for the analysis: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington DC. NCRC obtained creditworthiness data on a one time basis from a large credit bureau. As expected, the number of subprime loans increased as the amount of neighborhood residents in higher credit risk categories increased. After controlling for risk and housing market conditions, however, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending. In particular:

- The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition

[2] Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, Federal Reserve Bulletin, January 2003.

of a neighborhood boosted lending in six metropolitan areas.

- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.

Another NCRC study, *Fair Lending Disparities by Race, Income and Gender in all Metropolitan Areas in America (spring 2005)*, reveals striking lending disparities across the great majority of the 331 metropolitan areas in the United States. Specifically, minorities, women, and low- and moderate-income borrowers received a disproportionate share of subprime loans relative to prime loans. Lending disparities were compared to the level of segregation controlling for housing affordability across metropolitan areas. As segregation increased, the portion of subprime loans to African-Americans, Hispanics, and minority tracts increased faster than prime lending to these tracts. A segment of subprime lenders is targeting segregated neighborhoods with high cost loans.

Racially segregated neighborhoods remain entrenched across the nation, presenting opportunities for unscrupulous lenders to focus high cost lending on traditionally underserved populations. Segregation, particularly between African-Americans and whites, persists at unacceptable levels while Hispanic/white segregation has jumped in recent years.[3] Although African-Americans account for about 12 percent of the nation's total population and Hispanics for about 13 percent, the typical white resident of metropolitan areas lives in a neighborhood that is 80 percent white, 7 percent African-American, 8 percent Hispanic, and 4 percent Asian. A typical African-American person resides in a neighborhood that is 33 percent white, 51 percent African-American, 11 percent Hispanic, and 3 percent Asian. And a typical Hispanic resident lives in a community that is 36 percent white, 11 percent African-American, 45 percent Hispanic, and 6 percent Asian.

NCRC's findings were consistent with a wide variety of research on subprime lending. A survey study conducted by Freddie Mac analysts found that two-thirds of subprime borrowers were not satisfied with their loans, while three-quarters of prime borrowers believed they received fair rates and terms.[4] In previous years, Freddie Mac and Fannie Mae have often been quoted as stating that between a third to a half of borrowers who qualify for low cost loans receive subprime loans.[5] In the fall of 2005, the Federal

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[3] John Iceland, Daniel H., Weinberg, and Erika Steinmetz. 2002a. Racial and Ethnic Residential Segregation in the United States: 1980-2000. U.S. Census Bureau, Series CENSR-3. Washington, D.C.: U. S. Government Printing Office. Iceland, Weinberg, and Steinmetz, "Racial and Ethnic residential Segregation in the United States: 1980-2000." Paper presented at the annual meetings of the Population Association of America, Atlanta (May 9-11, 2002). Lewis Mumford Center. 2001. "Ethnic Diversity Grows, Neighborhood Integration Lags Behind." Available at http://mumford1.dyndns.org/cen2000/WholePop/WPreport/page1.html

[4] Freddie Mac analysts Marsha J. Courchane, Brian J. Surette, Peter M. Zorn, *Subprime Borrowers: Mortgage Transitions and Outcomes*, September 2002, prepared for Credit Research Center, Subprime Lending Symposium in McLean, VA.

[5] "Fannie Mae Vows More Minority Lending," in the Washington Post, March 16, 2000, page E01. Freddie Mac web page, http://www.freddiemac.com/corporate/reports/moseley/chap5.htm.

Reserve released an analysis of the 2004 data revealing racial disparities even after controlling for income levels, loan types, and geographical areas.[6] Dan Immergluck was one of the first researchers to document the "hypersegmentation" of lending by race of neighborhood.[7]

The Department of Housing and Urban Development also found that after controlling for housing stock characteristics and the income level of the census tract, subprime lending increased as the minority level of the tract increased.[8] Even the Research Institute for Housing America, an offshoot of the Mortgage Bankers Association, found that minorities were more likely to receive loans from subprime institutions, even after controlling for the creditworthiness of the borrowers.[9]

Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School also used credit scoring data to conduct econometric analysis scrutinizing the influence of credit scores, demographic characteristics, and economic conditions on the level of subprime lending. Their study found that after controlling for creditworthiness and housing market conditions, the level of subprime refinance and home purchase loans increased in a statistically significant fashion as the portion of African-Americans increased on a census tract level in Philadelphia and Chicago.[10]

Conventional Home Purchase Lending – Comparing Shares of Loans and Households

The following pages provide detailed analyses of current lending disparities. Access to and price of loans by race, income, gender, and immigration status are examined for home purchase, refinance, and home improvement lending, covering conventional and government-insured loans. The analysis also scrutinizes manufactured housing and second lien lending.

Race and Ethnicity of Borrower and Households

Across the country, lenders issued 3.3 million prime conventional home purchase loans and 433,902 subprime conventional home purchase loans in 2004 (see Table 1A). Conventional loans refer to loans that are not guaranteed by the federal government. If a

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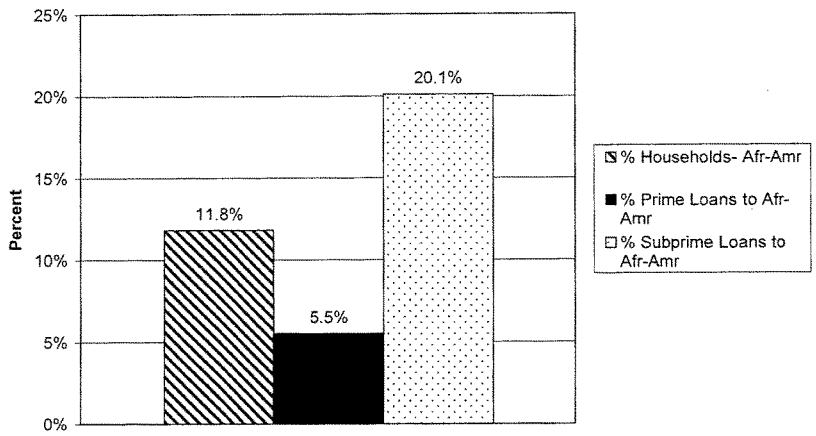
[6] Avery, Robert B., Glenn B. Canner, and Robert E. Cook, "New Information Reported under HMDA and Its Application in Fair Lending Enforcement." *Federal Reserve Bulletin*, Summer 2005.
[7] Dan Immergluck, *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development*, the Woodstock Institute, November 1999.
[8] Randall M. Scheessele, *Black and White Disparities in Subprime Mortgage Refinance Lending*, April 2002, published by the Office of Policy Development and Research, the U.S. Department of Housing and Urban Development.
[9] Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why*? Working Paper No. 00-03, published by the Research Institute for Housing America, September 2000.
[10] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov. Also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622

borrower is delinquent or defaults, the lender assumes any loses, not the federal government. Achieving homeownership via home mortgage loans is one of the primary means by which Americans obtain wealth. It is therefore vital to scrutinize trends in home purchase lending by race, gender, income, and immigration status to determine if minorities, working class borrowers and women have fair access to lower cost prime loans.

Minorities received a share of subprime loans that were greater than their share of the nation's households but received a share of prime loans that were smaller than their share of households. Minority neighborhoods also received a disproportionate amount of subprime loans.

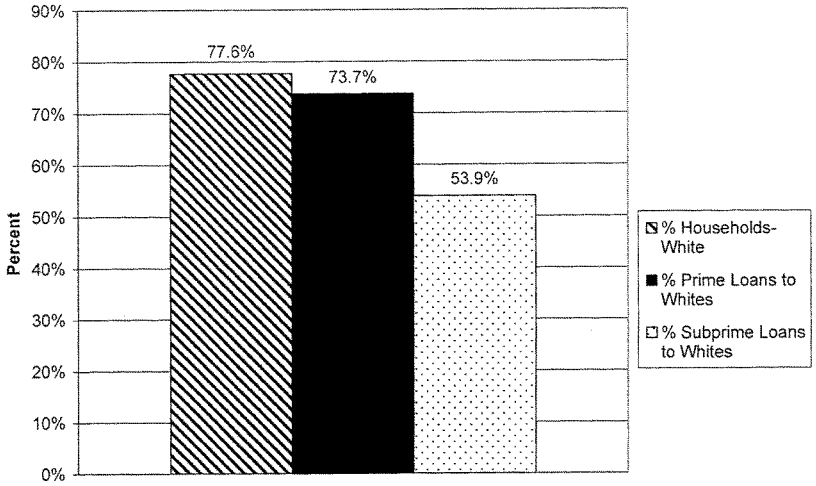
Graph 1: African-American Share of Home Purchase Loans and Households



African-Americans received a percent of subprime conventional home purchase loans that was considerably higher than their percent of the nation's households. In 2004, African-Americans received 20.1 percent of the subprime home purchase loans, but just 5.5 percent of the prime home purchase loans. African-Americans constituted 11.8 percent of the nation's households. For a variety of financial and other underwriting considerations, closing the gap between the percent of households and the percent of loans for traditionally underserved borrowers cannot be done immediately or even over a number of years. Nevertheless, we believe that a considerable portion of the gap can be closed if lenders, community organizations, and government officials work together in a collaborative manner to overcome impediments in access to credit.[11]

[11] The disparities discussed in this report reflect a number of factors including income, wealth, credit rating, and many others. Discrimination, of course, remains a significant factor. Several studies discussed above have found that even controlling on credit-related factors, disparities persist. The disparities between the share of households and shares of various types of loans do not necessarily reveal levels of discrimination

Graph 2: White Share of Home Purchase Loans and Households

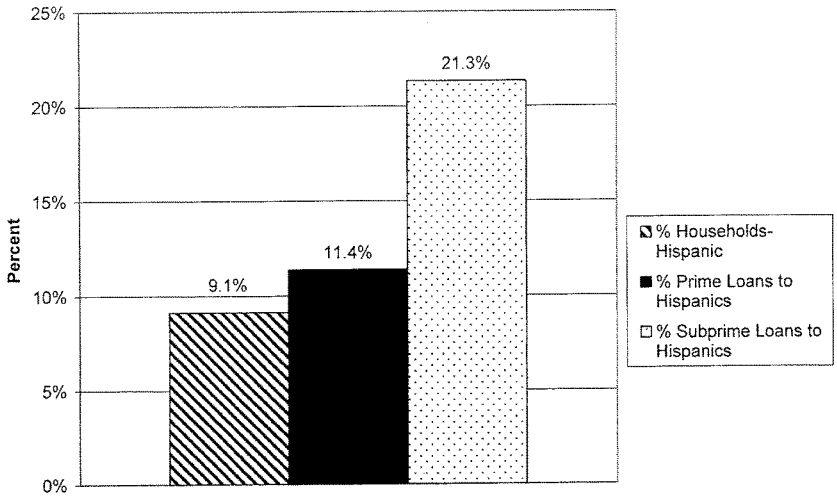


Whites, in contrast, received a share of subprime home purchase loans that was considerable lower than their share of the nation's households. Whites received 53.9 percent of the subprime home purchase loans but were 77.6 percent of the nation's households. Whites did not quite receive prime loans in proportion to their share of households, but were much closer than African-Americans to receiving loans in proportion to their portion of households. Whites obtained 73.7 percent of the prime home purchase loans and were 77.6 percent of the nation's households.

Hispanics, like African-Americans, received a portion of subprime loans that was greater than their portion of the nation's households. Hispanics were about 9.1 percent of the nation's households but received 21.3 percent of the subprime home purchase loans. On the positive side, they received a portion of prime loans (11.4 percent of loans) that was higher than their portion of the nation's households. Native-Americans received a portion of subprime home purchase loans (1.4 percent) that was higher than their share of the nation's households (.8 percent) and received a share of prime home purchase loans (.8 percent) that was commensurate with their share of the nation's households.

in the marketplace; but they do reveal the presence of ongoing barriers associated with socioeconomic factors.

Graph 3: Hispanic Share of Home Purchase Loans and Households



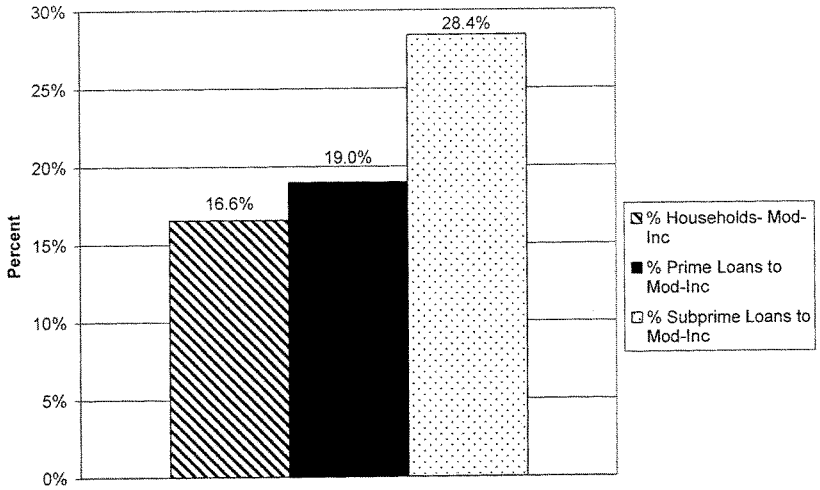
In contrast to the other racial groups including Whites, Asians received a higher portion of prime loans than their share of the nation's households. Asians were about 3.1 percent of the nation's households and received 6.4 percent of the prime home purchase loans during 2004. Asians received 3.1 percent of the subprime loans, which was equal to their share of the nation's households.

Income of Borrowers and Households

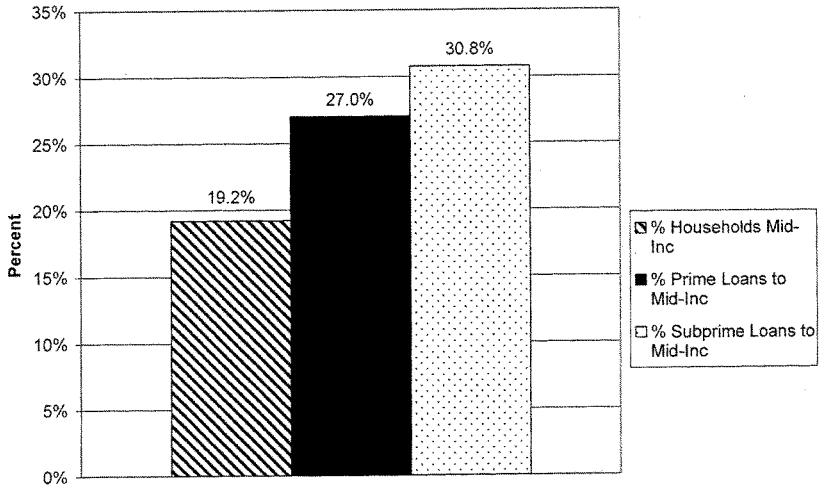
Due to various financial constraints, low-income households had the most difficulty obtaining prime and subprime loans in proportion to their share of the nation's households. Lending trends to moderate-income households exhibited greater disparities in their share of prime and subprime loans than their middle- and upper-income counterparts.

Low-income borrowers with incomes up to 50 percent of area median incomes had the most difficulty affording home loans (see Table 1A). Their difficulties with affordability were revealed by their portion of loans being considerably smaller than their portion of the nation's households. Low-income households were 23 percent of the nation's households. They obtained 9.9 percent of the conventional subprime home purchase loans and just 5.9 percent of the prime home purchase loans during 2004.

Graph 4: Moderate-Income Share of Home Purchase Loans and Households



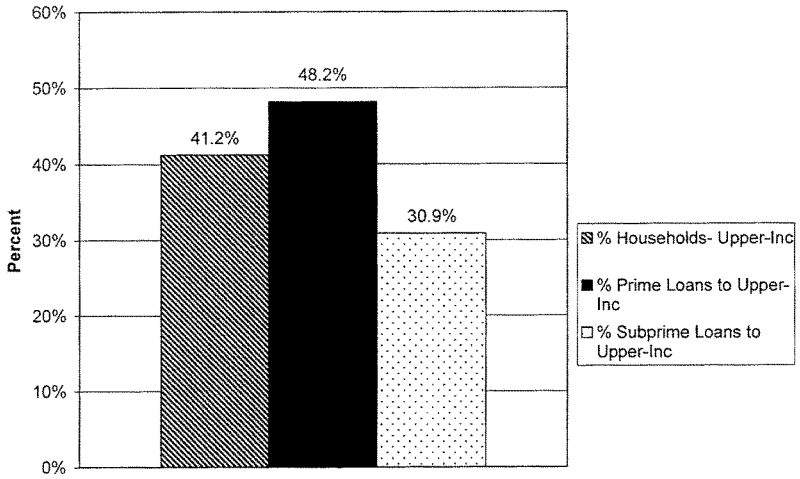
Graph 5: Middle-Income Share of Home Purchase Loans and Households



Moderate-income borrowers with incomes between 51 to 79 percent of area median income received a much higher portion of subprime loans than their portion of the nation's households. Moderate-income households were about 16.6 percent of the nation's households, but obtained 28.4 percent of the subprime loans. On the positive

side, they received a portion of prime loans (19 percent) that was higher than their portion of the nation's households. Middle-income borrowers with incomes between 80 to 120 percent of area median income received a higher portion of prime loans (27 percent) and subprime loans (30.8 percent) than their portion of the nation's households (19.2 percent).

Graph 6: Upper-Income Share of Home Purchase Loans and Households



In contrast to the trends for their lower income counterparts, upper-income households with incomes above 120 percent of area median income were issued a portion of prime loans that was higher than their portion of the nation's households but received a portion of subprime loans that was lower than their portion of the nation's households. Upper-income borrowers constituted 41.2 percent of the nation's households and received 48.2 percent of the prime home purchase loans and 30.9 percent of the subprime loans during 2004.

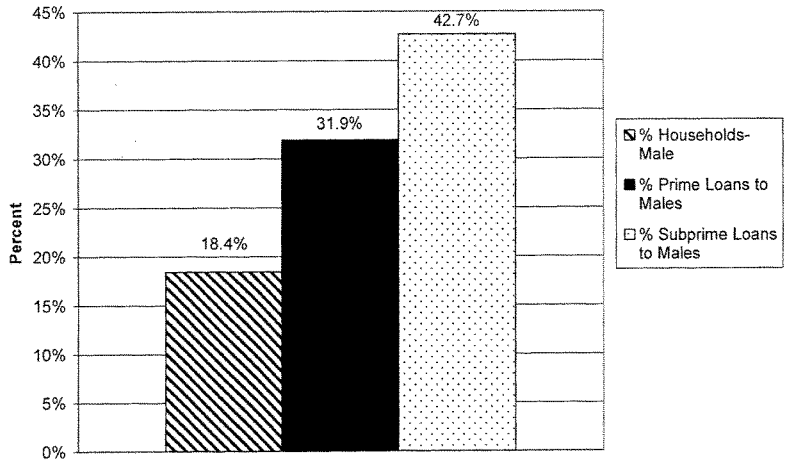
Gender of Borrowers and Households

Females of all races obtained a disproportionately low share of prime loans relative to male borrowers. Interestingly, joint borrowers (male and female applying together) fared better than their female or male only counterparts, most likely due to greater income and assets of joint borrowers.

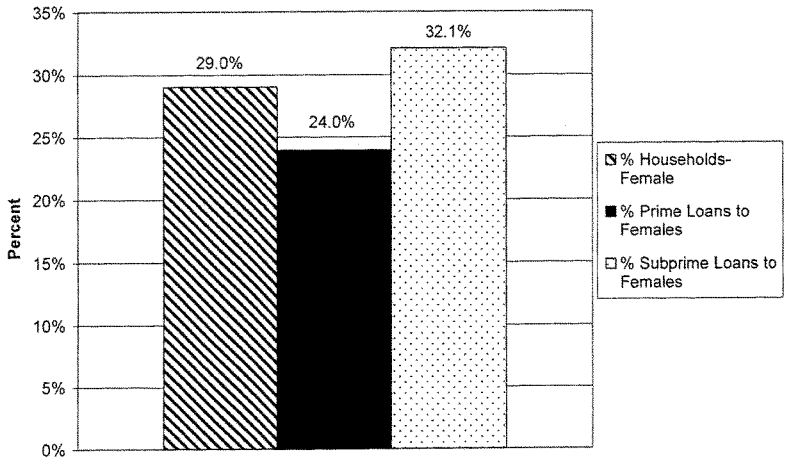
Females constituted 29 percent of the nation's households but obtained just 24 percent of the prime home purchase loans (see Table 1A). In contrast, females received 32.1 percent of subprime home purchase loans, a percent of loans that was greater than their percent of households. Unlike females, males obtained a share of prime loans (31.9

percent) that was considerably greater than their share of the nation's households (18.4 percent). Interestingly, however, the male share of subprime loans (42.7 percent) was significantly larger than their share of prime loans and their share of the nation's households.

Graph 7: Male Share of Home Purchase Loans and Households



Graph 8: Female Share of Home Purchase Loans and Households

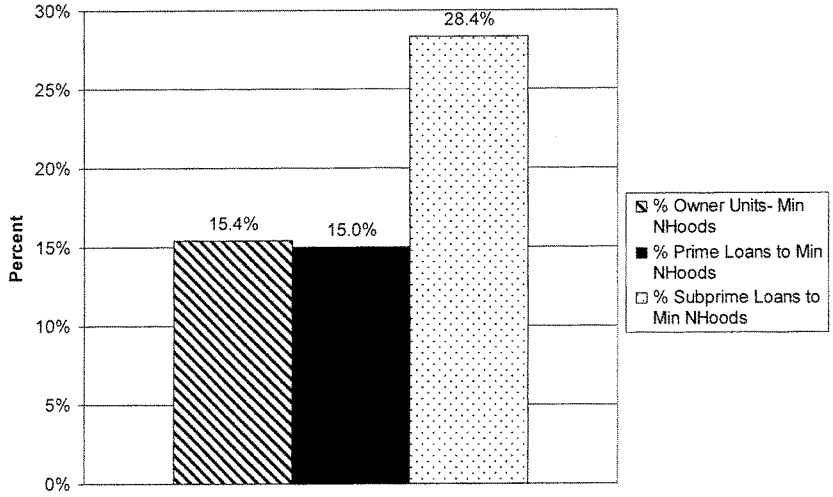


Joint borrowers fared better than their male and female counterparts. They obtained 44.1 percent of the prime home purchase loans and 25.2 percent of the subprime loans, meaning that their share of prime loans was almost 1.75 times greater than their share of subprime loans. In contrast, male and females applying alone had a greater percent of subprime than prime loans. Joint borrowers, however, were still not receiving prime loans in proportion to their share of the nation's households (of 52.5 percent).

Race of Neighborhood

Minority neighborhoods obtained a share of prime home purchase loans that was commensurate with their share of owner-occupied housing units but received a portion of subprime loans that was much greater than their share of the nation's owner-occupied housing units (see Table 1A). Relative to predominantly white neighborhoods, minority neighborhoods received a disproportionate amount of subprime loans.[12]

Graph 9: Minority Neighborhoods' Share of Home Purchase Loans and Owner Occupied Units



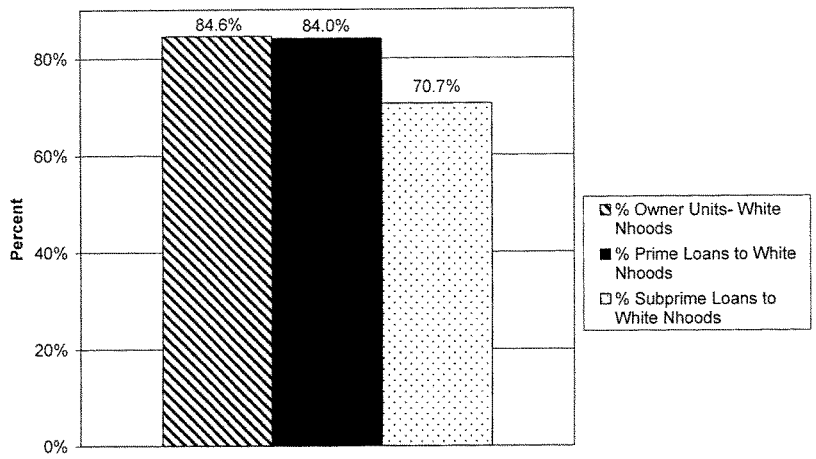
For neighborhoods, the portion of loans was compared to the portion of owner-occupied housing units. Above, comparisons were made between the share of households and the share of loans for borrowers. In contrast, a neighborhood analysis considered how many loans financial institutions were issuing to owner occupants of homeowner units, as opposed to rental units.[13] Analysis of lending for rental properties is important but

[12] Neighborhoods are defined as census tracts.

[13] Rental units are a hard constraint on lending in a neighborhood or census tract. Suppose a particular minority neighborhood contains mostly rental units. Lenders cannot issue mostly home purchase loans in that neighborhood because the majority of the units are rental. Hence, analyses on a neighborhood level

beyond the scope of this report. Finally, the focus here was on lending to owner-occupants instead of non-occupant investors who rent their single family units. Owners who live in their homes tend to have the most stake in their neighborhoods, so the analysis here focuses on this population.

Graph 10: White Neighborhoods' Share of Home Purchase Loans and Owner Occupied Units



Minority neighborhoods in which more than 50 percent of the residents were minorities contained 15.4 percent of the nation's owner occupied housing units. The positive news is that they received 15 percent of the prime home purchase loans, a portion of prime loans commensurate with their share of owner-occupied housing units. A worrisome finding, however, was that minority neighborhoods obtained 28.4 percent of the subprime home purchase loans, which was almost twice as great in percentage point terms than their share of the nation's owner-occupied housing units. White neighborhoods, in which less than 50 percent of the residents were minority, contained 84.6 percent of the nation's owner-occupied housing units and received 84 percent of the prime home purchase loans. In contrast to minority neighborhoods, white neighborhoods received a lower percent of subprime loans (70.7 percent) than their share of the nation's owner-occupied housing stock.

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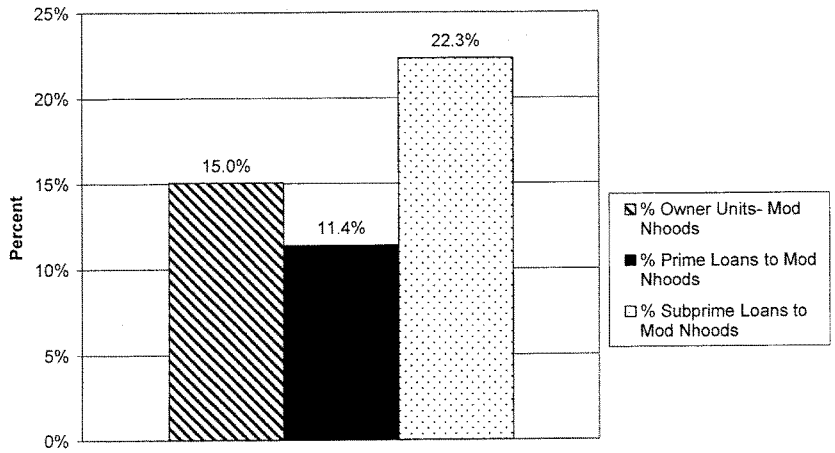
often compare the number and percent of loans to the number and percent of owner-occupied units. Federal regulators conduct these types of analyses on Community Reinvestment Act (CRA) exams. In contrast, analyses on a metropolitan or national level compare loans to households. In a metropolitan area or the nation, minorities are not confined to neighborhoods with mostly rental units. They can move to other neighborhoods with a mix of rental and owner units. Rental units do not serve as a hard constraint on a metropolitan or national level. Hence, when analyzing lending to groups of borrowers as a whole, analyses compare the number and percent of loans to the number and percent of households.

This report embarked on a new twist to HMDA data analysis by examining lending trends in neighborhoods with high percentages of foreign-born immigrants. Thanks to researchers at Suny-Albany University, this report identified a group of neighborhoods in which more than 50 percent of the residents were foreign-born immigrants.[14] Immigrant neighborhoods constituted 1.2 percent of the nation's owner-occupied housing stock. Unlike minority neighborhoods, immigrant neighborhoods were issued a share of prime (2.9 percent) and subprime loans (1.9 percent) that was greater than their share of the owner-occupied housing stock. Interestingly, the immigrant prime share of loans was considerably greater than their subprime share of home purchase loans.

Income Level of Neighborhood

Low-income, moderate-income, and even middle-income neighborhoods did not obtain a portion of prime home purchase loans commensurate with their share of the nation's owner-occupied housing units (see Table 1A). Low- and moderate-income neighborhoods, moreover, received a share of subprime loans that was greater than their share of the nation's owner-occupied housing units.

Graph 11: Moderate-Income Neighborhoods' Share of Home Purchase Loans and Owner Occupied Units

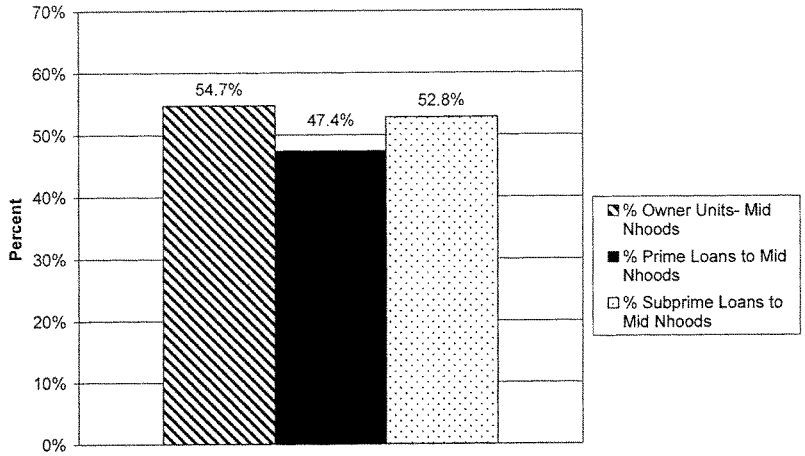


Low-income and moderate-income neighborhoods obtained 3.4 percent and 22.3 percent of the subprime home purchase loans, respectively. This was a greater percent than their share of the nation's owner-occupied units at 1.7 percent and 15 percent, respectively. In addition, their share of prime loans was disproportionately low. Moderate-income

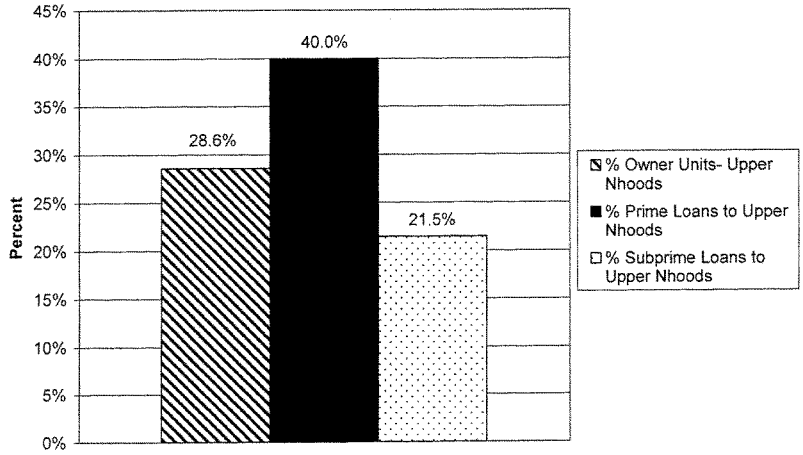
[14] There are 1,542 census tracts in the country in which 50 percent or more of the population are foreign-born.

neighborhoods, for instance, received 11.4 percent of the prime home purchase loans but had 15 percent of the owner-occupied housing stock.

Graph 12: Middle-Income Neighborhoods' Share of Home Purchase Loans and Owner Occupied Units



Graph 13: Upper-Income Neighborhoods' Share of Home Purchase Loans and Owner Occupied Units



Even middle-income neighborhoods had an imbalance of prime and subprime lending. Middle-income neighborhoods were issued 47.4 percent of the prime loans and 52.8 percent of the subprime loans, and had 54.7 percent of the nation's owner-occupied housing units. In sharp contrast, upper-income neighborhoods had significantly greater percentages of prime than subprime loans. Upper-income neighborhoods obtained 40 percent of the prime home purchase loans, received just 21.5 percent of the subprime loans, and had 28.6 percent of the nation's owner-occupied housing stock. In other words, their portion of prime loans was much greater than their portion of the owner-occupied stock whereas their portion of subprime loans was lower than their portion of the owner-occupied stock. Relative to their upper-income counterparts, all other income groups of neighborhoods, even middle-income ones, had difficulties accessing shares of prime loans proportional to their owner-occupied housing stock.

Conventional Refinance Lending

Race and Ethnicity of Borrower and Households

Lenders issued 4.8 million prime conventional refinance loans and 886,536 subprime conventional refinance loans during 2004. Most subprime loans were refinance loans. The absolute number of subprime refinance loans (886,536) was twice that of subprime home purchase loans (433,902). Also, a greater percent of refinance loans were subprime (15.4 percent) than all single family loans (14.2 percent). Investigating trends by race, gender, and income was particularly important in refinance lending since subprime lending was such a significant amount of refinance lending (see Table 1C). Non-whites, except for Asians, received a disproportionate amount of subprime loans, as was the case with home purchase lending.

African-Americans obtained a disproportionate number of subprime conventional refinance loans during 2004. They were 11.8 percent of the nation's households but received 19 percent of the subprime refinance loans and just 6.4 percent of the prime refinance loans. Hispanics also received a disproportionate amount of subprime refinance loans, but not to the same magnitude as African-Americans. Constituting 9.1 percent of the nation's households, Hispanics received 13.7 percent of the subprime refinance loans and 10.6 percent of the prime loans during 2004. Native Americans were about .8 percent of the nation's households and obtained 1.3 percent and .9 percent of the subprime and prime refinance loans, respectively.

Asians and whites received a portion of subprime loans that was lower than their portion of the nation's households and were issued a share of prime loans that was commensurate with their share of the nation's households. Asians were about 3.1 percent of the nation's households. They received 1.7 percent of the subprime refinance loans and 4.8 percent of the prime refinance loans during 2004. Non-Hispanic whites were about 77.6 percent of the nation's households. They obtained 74.9 percent of the prime refinance loans and 62.9 percent of the subprime refinance loans.

Income of Borrower and Households

Both low-income and moderate-income borrowers of all races received a percent of subprime loans that was considerably higher than their percent of prime loans. Low-income borrowers obtained 12.2 percent of all refinance subprime loans but just 6.7 percent of prime refinance loans. Low-income borrowers were 23 percent of the nation's households. Low-income households received a share of subprime and prime loans that was considerably smaller than their share of the nation's households, suggesting that affordability issues constituted a significant constraint in their access to credit. In contrast, moderate-income households received a share of prime loans (19.4 percent) that was greater than their share of the nation's households (16.6 percent). Moderate-income households, however, obtained a share of subprime refinance loans (28.4 percent) that was much greater than their share of the nation's households (see Table 1C).

Middle-income borrowers of all races received a percent of prime and subprime loans that was higher than their percent of the nation's households. They obtained 28.4 percent of prime refinance loans, 31.2 percent of subprime refinance loans, but were just 19.2 percent of the nation's households. Upper-income borrowers were the only group of borrowers that received a portion of prime loans that was greater than their share of subprime loans or their share of the nation's households. Upper-income borrowers received 45.5 percent of all prime refinance loans. In stark contrast, upper-income borrowers received just 28.3 percent of the subprime refinance loans. Upper-income borrowers were 41.2 percent of the nation's households.

Gender of Borrower and Households

Males, unlike females, received a portion of prime loans that was greater than their portion of the nation's households. Just as was the case in home purchase lending, joint borrowers enjoyed the most favorable lending patterns, with their percent of prime loans greater than their percent of subprime loans.

Males constituted 18.4 percent of the nation's households (see Table 1C). Their portion of prime loans (25.7 percent) was greater than their portion of the nation's households, but their portion of subprime loans (31 percent) was greater than their portion of prime loans. Females did not fare as well as their male counterparts. They received 21.8 percent of the prime refinance loans but were 29 percent of the nation's households. Moreover, they received 28.7 percent of the subprime refinance loans during 2004.

Joint borrowers, probably due to their greater amounts of income and assets, were the only group of borrowers that received a share of prime loans that was equal to their share of the nation's households at 52.5 percent. In addition, they obtained just 40.3 percent of the subprime refinance loans, which was considerably less than their portion of the nation's households.

Race of Neighborhood

Minority neighborhoods did not fare as well as either white or immigrant neighborhoods, but they at least received a share of prime loans that was commensurate with their share of the nation's owner-occupied housing units. Minority neighborhoods garnered 17.9 percent of all prime refinance loans. They had 15.4 percent of the nation's owner-occupied housing units. However, these neighborhoods received 28.4 percent of the subprime refinance loans, which was almost twice as much in percentage point terms as their share of owner-occupied housing units (see Table 1C).

Like minority neighborhoods, immigrant neighborhoods were issued a portion of prime refinance loans that was greater than their share of the nation's owner-occupied housing units. Immigrant neighborhoods were issued 3.8 percent of prime loans, which was greater than their share of the nation's owner-occupied housing stock of 1.1 percent. Unlike minority neighborhoods, immigrant neighborhoods had a share of subprime loans of 1.4 percent that was not much greater than their share of the nation's owner-occupied housing stock.

Predominantly white neighborhoods contained 84.6 percent of the nation's owner-occupied housing stock and received 81.2 percent of the prime refinance loans. They obtained a portion of subprime refinance loans (70.9 percent) that was significantly smaller than their share of the nation's owner-occupied housing units.

Income of Neighborhood

Low- and moderate-income neighborhoods received a percent of subprime loans that was proportionally greater than their share of the nation's housing units, in contrast to middle- and upper-income neighborhoods. While low-income neighborhoods comprised 1.6 percent of the nation's owner-occupied housing units, they received 3 percent of the subprime refinance loans and 1.2 percent of the prime refinance loans in 2004 (see Table 1C). Similarly, the moderate-income neighborhood share of subprime refinance loans (22.7 percent) was greater than their share of the nation's owner-occupied housing stock (15 percent) and their share of prime loans (12.1 percent).

Middle-income neighborhoods, in contrast to low- and moderate-income neighborhoods, received a share of subprime loans (55 percent) that was equal to their share of the nation's owner-occupied housing units. However, even middle-income neighborhoods obtained a percent of prime refinance loans (49.1 percent) that was smaller than their percent of subprime refinance loans. Only upper-income neighborhoods received an unambiguously favorable lending outcome. Containing 28.6 percent of the nation's owner-occupied housing stock, these neighborhoods obtained 37.6 percent of the prime refinance loans and 19.2 percent of subprime refinance loans in 2004.

Conventional Home Improvement Lending

Racial disparities remain in conventional home improvement lending, but were not as

pronounced as in home purchase or refinance lending. For example, Hispanics received 13 percent of prime home improvement loans and received a slightly lower portion of prime home purchase loans (11.4 percent) (see Table 1B). In contrast, Hispanics received a much higher portion of subprime home purchase loans (21.3 percent) as opposed to subprime home improvement loans (15.1 percent).

Low-income borrowers received higher portions of home improvement lending than home purchase or refinance lending. Low-income borrowers were issued just 5.9 percent of prime home purchase loans and 6.7 percent of refinance loans, but received 10.3 percent of home improvement loans.

Minority and immigrant neighborhoods also fared the best in home improvement lending as opposed to the other loan types. Minority neighborhoods obtained 21.7 percent of prime home improvement loans, but just 17.9 percent and 15 percent of prime refinance and home purchase lending, respectively. Lending trends in immigrant neighborhoods was also most favorable for home improvement lending as the percent of prime loans was highest in home improvement lending while the percent of subprime loans differed by about half a percentage point or less among the three loan types.

It is not clear why the portion of prime loans was highest to traditionally underserved borrowers in home improvement lending. Underwriting may be easier for home improvement lending. The borrowers of home improvement loans already own their homes and have likely acquired significant amounts of wealth in contrast to first time homebuyers. In addition, loan-to-value ratios are usually smaller for home improvement lending than home purchase or refinance lending, making it easier for borrowers to qualify for home improvement lending. Yet, as reported below, subprime loans accounted for a higher portion of all home improvement loans than home purchase or refinance loans. Both prime and subprime lenders may find underwriting home improvement loans easier but subprime lenders may be increasing their number of home improvement loans to a greater amount than prime lenders.

Government-Insured Single Family Lending

Lenders issued 746,930 prime government-insured loans and only 10,564 subprime government-insured loans in 2004. Government-insured loans are backed by the federal government. In the event of borrower default, the federal government assumes any losses associated with the loan. As a percent of total loans, subprime loans were 1.4 percent of government insured loans. In contrast, subprime loans were 11.5 percent of conventional home purchase loans in 2004 (see Table 1E). Subprime lending levels were considerably lower in government-insured loans because the federal government was assuming the risk. In contrast, the lending institution assumes the risk in conventional lending and recoups costs of default through higher interest rates on loans to borrowers with imperfect credit.[15]

[15] It is beyond the scope of this report to precisely compare the costs of federally-insured and conventional lending to borrowers. A subprime loan represents a considerably higher cost to a borrower than a prime loan. Government-insured loans also cost more to the borrower than conventional prime loans because

Interestingly, African-Americans were issued government-insured lending relatively free of disparities while other racial and ethnic groups were still confronted with disparities in government-insured lending. African-Americans obtained 16.3 percent and 15.2 percent of prime and subprime government-insured loans, respectively. The percent of prime and subprime government-insured lending to African-Americans was higher than the percent of households that were African-American (11.8 percent). In contrast, Hispanics received a higher portion of subprime government-insured loans (22.8 percent) than prime loans (14 percent). The good news for Hispanics was that their percent of prime government-insured loans was higher than their percent of the nation's households (9.1 percent). Asians, in contrast, did not fare as well, receiving a portion of prime and subprime government-insured loans that was lower than their share of the nation's households.

Low-income borrowers obtained a better outcome in government-insured lending than conventional lending. Their percent of prime and subprime government-insured lending (12.1 percent and 14 percent, respectively) is higher than their percent of conventional prime and subprime lending. Moderate- and middle-income borrowers received equal shares of prime and subprime government-insured loans; their percent of prime and subprime loans was considerably greater than their share of the nation's households.

Unfortunately, minority neighborhoods did not have unambiguously good outcomes. They received 19.5 percent of the prime government-insured loans, which was higher than their 15.4 percent share of the nation's owner-occupied housing stock. But these neighborhoods received a disproportionately high 27.9 percent of subprime loans. In contrast, white neighborhoods were issued higher shares of prime than subprime government-insured loans.

Manufactured Home Lending

The 2004 HMDA data has a new data field indicating if the loan is for a traditional, site built single family home or if the loan is for a manufactured home that is built off-site. Manufactured lending volumes were a small fraction of overall lending volumes. All traditional single-family lending (home purchase, refinance, and home improvement) equaled 8.4 million prime and 1.4 million subprime loans during 2004. Manufactured home lending, in contrast, was at 83,062 prime loans and 95,500 subprime loans (see Table 1F).

In stark contrast to all single family lending, manufactured lending featured more subprime loans than prime loans. Subprime lending was a greater portion of manufactured home lending because manufactured home lending has traditionally been a riskier form of lending than lending for traditional site built homes. Manufactured home lending was also considerably more targeted to low- and moderate-income borrowers and less focused on lending to minorities than all single family lending. The patterns of lending by neighborhood also revealed less focus on working class and minority

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government-insured loans typically have higher fees than conventional loans. On average, however, the cost of subprime conventional loans is higher than the cost of government-backed loans to borrowers.

neighborhoods for manufactured home lending than all single family lending. This was perhaps due to the large amount of manufactured home lending in rural areas in the South and West; rural areas have fewer distinctly lower income or minority census tracts.

Manufactured home lending did not reach racial or ethnic minorities to the same extent as all single family lending. African-Americans received only 2.7 percent of prime and 6.9 percent of subprime manufactured home lending. In contrast, African-Americans obtained 6 percent of prime single family loans and 19.3 percent of subprime single family loans (see Table 1D). The trends were similar for Hispanics – Hispanics received 5.5 percent of prime manufactured home loans and 11 percent of prime single family loans.

Low- and moderate-income borrowers received significantly higher portions of manufactured home loans than single-family loans. Low-income borrowers obtained 16.3 percent of prime manufactured home loans as opposed to just 6.5 percent of prime single family loans in 2004. For low-income borrowers, the portion of subprime manufactured home loans (23.1 percent) was also much higher than the portion of subprime all single-family loans (11.8 percent). Moderate-income borrowers also obtained significantly higher portions of prime and subprime manufactured home loans than all single family loans. For example, moderate-income borrowers received 31.2 percent of prime manufactured home loans and 19.3 percent of prime single family loans.

The much lower volumes of manufactured home loans than all single family loans must be remembered when considering the higher percent of manufactured home loans for low- and moderate-income borrowers. For instance, despite the higher percent of prime manufactured home loans than all single family loans for moderate-income borrowers, these borrowers received 25,024 manufactured home loans as opposed to 1.5 million single family loans during 2004. Yet, for certain counties of the country such as the South, the absolute numbers of these different loan types may not be as skewed towards all single family lending for modest income borrowers. As is widely known, the manufactured home sector has encountered difficulties with fraudulent practices and shoddy products. The manufactured home sector will realize its potential providing lower income families with decent and affordable homes only if industry continues to undertake significant reforms.

Second Lien Single Family Lending

The 2004 HMDA data has a new and important data field that records second or junior lien lending. Often borrowers will supplement a home purchase mortgage with a second mortgage loan of 10 or 20 percent that covers some or all the down payment. In addition, junior lien lending is a popular form of home improvement lending. Lending institutions making junior liens do not have the first claim on the property should the borrower default. In some cases, junior lien lending such as for home improvements is a less risky form of lending for borrowers than refinancing and taking out another first lien loan. In other cases, second lien loans can put borrowers in too much debt. In some cases,

borrowers should have saved more to cover down payments rather than taking out first and second lien loans with very high combined loan to value ratios.
Scrutinizing second lien lending assists stakeholders in determining whether this form of lending is being used responsibly or is adding to overall risk to borrowers and lenders. During 2004, second lien lending was a significant portion of the overall lending marketplace. Second lien prime loans were just over 1 million loans as compared to 8.4 million prime first lien loans. In general, lower percentages of prime and subprime second lien loans were made to lower-income and minority borrowers. On the one hand, efforts should be made to increase access to second-lien loans for traditionally underserved borrowers. On the other hand, until stakeholders have a firmer grasp of the benefits and risks of second lien loans, the lower percentages of these loans to traditionally underserved borrowers may reflect prudent lending practices (see Tables 1D and 1G).

Minorities generally received lower percentages of prime and subprime second lien loans compared to first lien single family lending. African-Americans, for instance, obtained 5.7 percent of prime second lien loans in contrast to 6 percent of prime first lien loans. The percent of subprime loans for African-Americans was also lower for second-liens than first liens. African-Americans received 15.3 percent of subprime second lien loans but 19.2 percent of subprime first lien loans (see Tables 1D and 1G).

In contrast, trends to Hispanics bear careful scrutiny as they received a greater percent of subprime second lien than first lien loans. These borrowers received a significantly greater share of subprime second lien loans (22.6 percent) than subprime first lien loans (16.3 percent). At the same time, Hispanics had a smaller share of prime second lien than first lien loans. Hispanics obtained 9.9 percent of prime second lien loans and 11 percent of prime first lien loans.

Low- and moderate-income borrowers were issued lower portions of second lien than first lien loans. Low-income borrowers received 3.9 percent and 4.4 percent of prime and subprime second-lien loans, respectively. In contrast, they obtained 6.5 percent and 11.8 percent of prime and subprime first lien loans, respectively. Moderate-income borrowers were issued just 16.2 percent of prime and 21 percent of subprime second lien loans. Their share of prime first lien loans (19.2 percent) and subprime first lien loans (28.4 percent) was higher than their shares of second lien loans. These trends of lower percentages of second lien loans held for females, substantially minority neighborhoods, and low- and moderate-income neighborhoods.

Market Share Analysis

Up to this point, the analysis has focused on comparing the percent of loans to the percent of households or owner-occupied housing units. In addition, racial, income, and gender groups have been considered in isolation. Another valuable type of analysis is market share analysis. Market share analysis compares the percent of loans that are subprime to various groups of borrowers and neighborhoods. For example, the analysis will compare the percent of all loans that are subprime issued to African-Americans versus whites. If

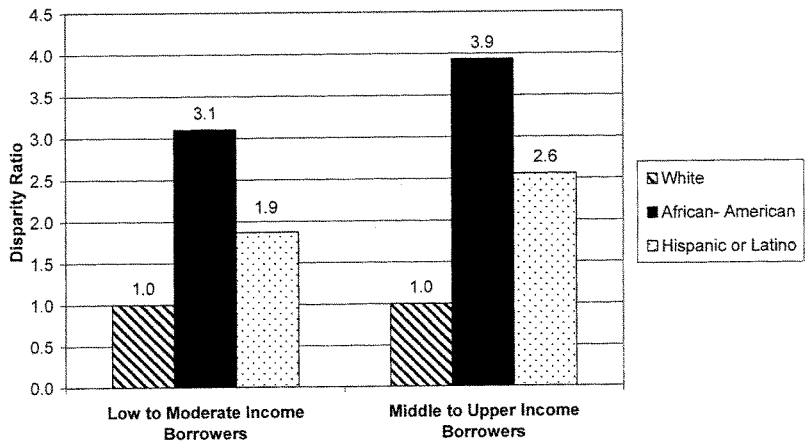
subprime loans are 30 percent of the loans to African-Americans versus 10 percent of the loans to whites, the market share of financial institutions making subprime loans is 3 times greater to African-Americans than their market share to whites. In other words, African-Americans are 3 times more likely to receive subprime loans than whites. This section will make comparisons of this nature. In addition, the section will overlay race, income, and gender. For instance, the subprime market share to low- and moderate-income African-Americans will be compared to the market share to low- and moderate-income whites. Finally, the section will focus on conventional home purchase, refinance, and home improvement lending since these were the loan types with the greatest volumes of subprime loans.

Conventional Home Purchase Lending – Race by Borrower Income

Home purchase lending was the type of lending that exhibited the greatest disparities in subprime market share by race and income of borrower. Moreover, the disparities became greater when considering middle- and upper-income (MUI) borrowers as opposed to low- and moderate-income borrowers (LMI).

The differences in subprime market share by race were stark. Subprime lending accounted for 39 percent of all home purchase loans to LMI African-Americans but just 12.6 percent of all loans to LMI whites (see Table 2A). The subprime market share to LMI African-Americans was 3.1 times greater than the subprime share to white borrowers (39 percent divided by 12.6 percent). In other words, LMI African-Americans were 3.1 times more like to receive subprime loans than LMI whites.

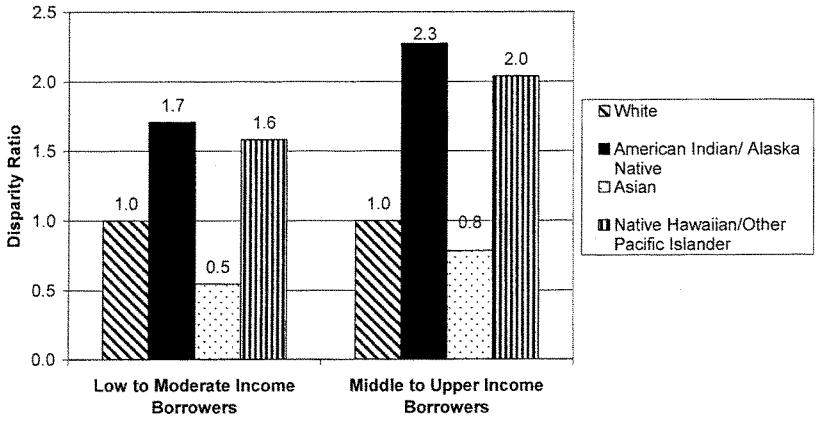
Graph 14: Home Purchase Lending-
Racial Disparities in Subprime Market Share Relative to Whites
Whites Compared to African-Americans and Hispanics by Borrower Income



A troublesome finding was that the racial disparity in subprime market shares was higher for middle- and upper-income borrowers than for low- and moderate-income borrowers. Subprime loans constituted 28.4 percent of the loans to MUI African-Americans but only 7.2 percent of the loans to MUI whites in 2004. Dividing the subprime MUI African-American by the MUI white market share leads to a finding that MUI African-Americans were 3.9 times more likely than MUI whites to receive subprime loans. This was significantly higher than the 3.1 times differential for LMI African-Americans versus LMI whites. The higher disparity for MUI African-Americans versus MUI whites reflected the fact that the subprime market share for MUI whites (7.2 percent) was almost half the market share as for LMI whites (12.6 percent). Subprime market share dropped much further for MUI whites than for MUI African-Americans.

The trend of greater disparities for MUI borrowers held for Hispanics, Native Hawaiians, and Native Americans. Subprime loans were 23.5 percent of the home purchase loans to LMI Hispanics; LMI Hispanics were 1.9 times more likely than LMI whites to receive subprime loans. On the other hand, MUI Hispanics were 2.6 times more likely to receive subprime loans than MUI whites. Subprime loans comprised a lower percent of all loans to MUI Hispanics than LMI Hispanics (18.4 percent and 23.5 percent, respectively). However, the greater disparity for MUI Hispanics versus MUI whites reflected the fact that the subprime market share for MUI whites dropped even further to 7.2 percent from 12.6 percent for LMI whites.

Graph 15: Home Purchase Lending-
Racial Disparities in Subprime Market Share Relative to Whites
Whites Compared to American Indian/Alaska Natives, Asians, and Native Hawaiian/ Other Pacific Islanders by Borrower Income



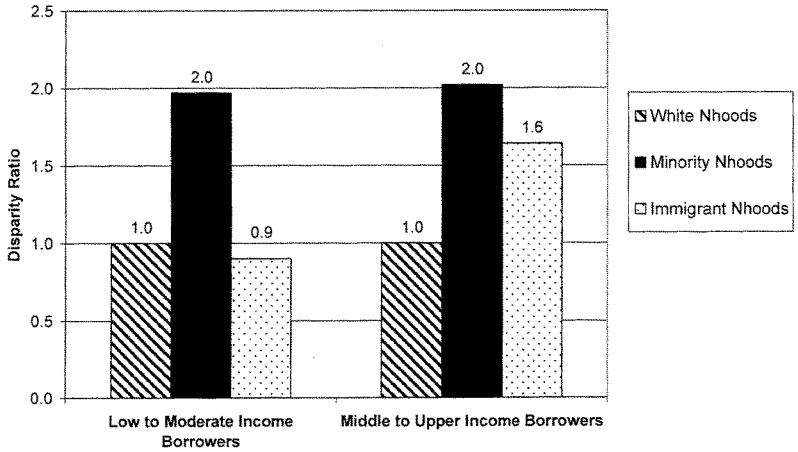
LMI Native Hawaiians were 1.6 more times likely than LMI whites to receive subprime loans but MUI Hawaiians were 2 times more likely than MUI whites to receive subprime loans. Finally, LMI Native Americans were 1.7 times more likely than LMI whites to

receive subprime loans, but MUI Native Americans were 2.3 times more likely than MUI whites to receive subprime home purchase loans during 2004.

Asians were the one racial minority group less likely than whites to receive subprime home purchase loans. Subprime loans were 12.6 percent of all home purchase loans to LMI whites, but were just 6.9 percent of the loans to LMI Asians. The subprime market share of loans was just about half (.547) as much to LMI Asians as to LMI whites. The same pattern held for MUI borrowers. The subprime market share of loans to MUI Asians was .78 as much as to MUI whites.

Racial disparities in subprime market share between minority and white neighborhoods were as high for middle- and upper-income borrowers as for low- and moderate-income borrowers. Subprime lending accounted for 28.5 percent of all home purchase loans to LMI borrowers in minority neighborhoods during 2004 (see Table 4A). In contrast, subprime loans were 14.5 percent of all the loans to LMI borrowers in white neighborhoods. The subprime market share was 2 times greater to LMI borrowers in minority neighborhoods than to LMI borrowers in white neighborhoods. In other words, LMI borrowers in minority neighborhoods were 2 times more likely than their LMI counterparts in white neighborhoods to receive subprime loans. MUI borrowers in minority neighborhoods were also 2 times more likely than MUI borrowers in white neighborhoods to receive subprime loans. Subprime loans made up 16.9 percent of the loans to MUI borrowers in minority neighborhoods and were 8.3 percent of the loans to MUI borrowers in white neighborhoods.

Graph 16: Home Purchase Lending-
Racial Disparities in Subprime Market Share Relative to White Neighborhoods
White Neighborhoods Compared to Minority and Immigrant Neighborhoods by Borrower Income

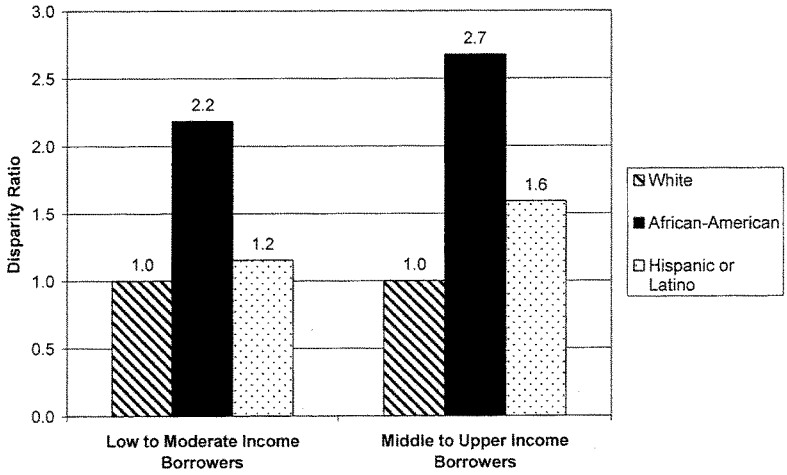


Subprime market share disparities between white and immigrant neighborhoods were larger when the income levels of borrowers increased. The subprime market share in immigrant neighborhoods was .9 times as much as their share in white neighborhoods for LMI borrowers. In contrast, MUI borrowers in immigrant neighborhoods were 1.6 times more likely to receive subprime loans than MUI borrowers in white neighborhoods. Subprime loans were 13.6 percent of the loans to MUI borrowers in immigrant neighborhoods but just 8.3 percent of the home purchase loans to MUI borrowers in white neighborhoods.

Conventional Refinance Lending – Race by Borrower Income

Except for Asians, the subprime market share to racial and ethnic minorities was greater than the subprime market share to whites (see Table 2B). Moreover, the difference in the subprime market share between minorities and whites increased for MUI borrowers relative to LMI borrowers.

Graph 17: Refinance Lending-
Racial Disparities in Subprime Market Share Relative to Whites
Whites Compared to African-Americans and Hispanics by Borrower Income



Subprime loans comprised a high 41.9 percent of all refinance loans to LMI African-Americans. In contrast, subprime loans were 19.2 percent of refinance loans to LMI whites in 2004. LMI African-Americans were 2.2 times more likely than LMI whites to receive subprime loans. Even for MUI African-Americans, subprime loans made up a large percentage (30.2 percent) of all refinance loans. Moreover, the subprime market share to MUI African-Americans was 2.7 times larger than the subprime market share to MUI whites.

The disparity in the subprime market share being higher for minority borrowers relative to white borrowers as borrower income increased held for all other racial and ethnic minorities except for Asians. For instance, MUI Hispanics were 1.6 times more likely than MUI whites to receive subprime refinance loans whereas LMI Hispanics were 1.2 times more likely than LMI whites to receive subprime refinance loans. In contrast, the subprime market share was higher to whites than to Asians, regardless of the income level of the borrowers.

Conventional Home Improvement Lending – Race by Borrower Income

Subprime loans were a greater percentage of home improvement lending for all racial groups of borrowers. The disparities in market share among racial groups were narrower in home improvement lending than in other types of lending. Narrower disparities can occur when subprime lending levels are high or low in a particular type of lending.

Subprime lending accounted for 48.3 percent of all home improvement loans for LMI African-Americans (see Table 2C). In contrast, subprime loans were 41.9 percent of all refinance loans for LMI African-Americans and 39 percent of all home purchase loans for LMI African-Americans. The patterns were similar for other racial groups. Subprime loans comprised 26.5 percent of all home improvement loans to LMI whites, but just 12.6 percent of the home purchase loans to LMI whites.

High subprime home improvement loan volumes for all borrower groups were accompanied by lower differences among racial groups in subprime market share. Subprime market share of home improvement loans to LMI African-Americans was 1.8 times greater than to LMI whites in 2004. But for home purchase lending, subprime market share was 3.1 times greater to LMI African-Americans than to LMI whites. Similarly, subprime market share of home improvement loans for LMI Hispanics was 1.1 times greater than for LMI whites; for home purchase lending, the difference in subprime market share was 1.9 times for these borrowers.

Although subprime market share differences were narrower for home improvement loans, the differences were still wider for MUI borrowers than LMI borrowers. For instance, the subprime market share of home improvement loans for MUI African-Americans was 2.3 times higher than for MUI whites. In contrast, for LMI African-Americans, the subprime market share was 1.8 times higher than for LMI whites.

Market Share Analysis – Race, Gender, and Income of Borrower

Conventional Home Purchase Lending

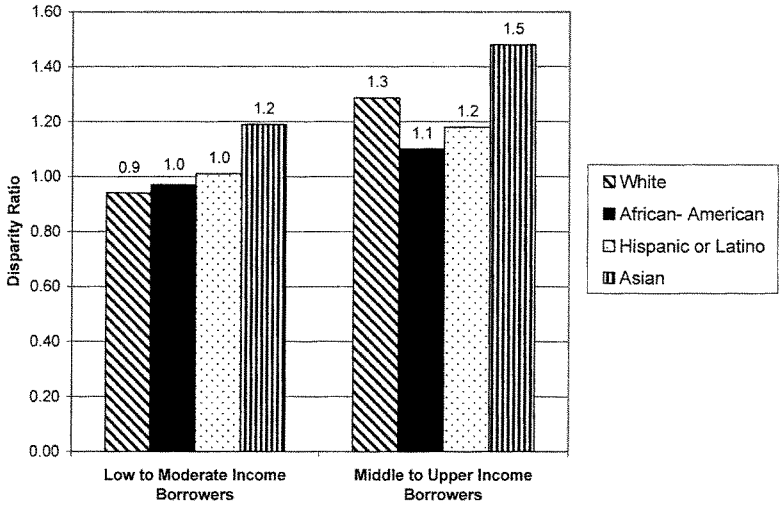
When examining the interplay among race, gender, and income the familiar patterns of subprime market share emerged with a new twist. Subprime market share of loans was a greater percentage of loans for LMI borrowers than MUI borrowers. However, the difference in subprime market share between white and minority borrowers was greater for MUI borrowers than LMI borrowers. The new twist was that disparities in subprime

market share between females and males of the same racial group also increase for MUI borrowers relative to LMI borrowers.

As expected, subprime market share was higher for LMI borrowers than MUI borrowers. For example, subprime lending accounted for 12.1 percent of the home purchase loans to LMI white females but 8.7 percent of the loans to MUI white females (see Table 3A). Likewise, subprime loans comprised 38.5 percent of the loans to LMI African-American females and 30 percent of the loans to MUI African-American females.

The disparity in subprime market share between white and minority females was higher for MUI borrowers then LMI borrowers. The subprime market share of loans to LMI African-American females is 3.2 times greater than to LMI white females. The subprime market share of home purchase loans to MUI African-American females was 3.4 times greater than the market share of loans to MUI white females.

Graph 18: Home Purchase Lending-
Gender Disparities in Subprime Market Share Relative to Males
Females by Borrower Race and Income



Note: For each race and income group, the subprime market share to females is divided by the subprime market share to males.

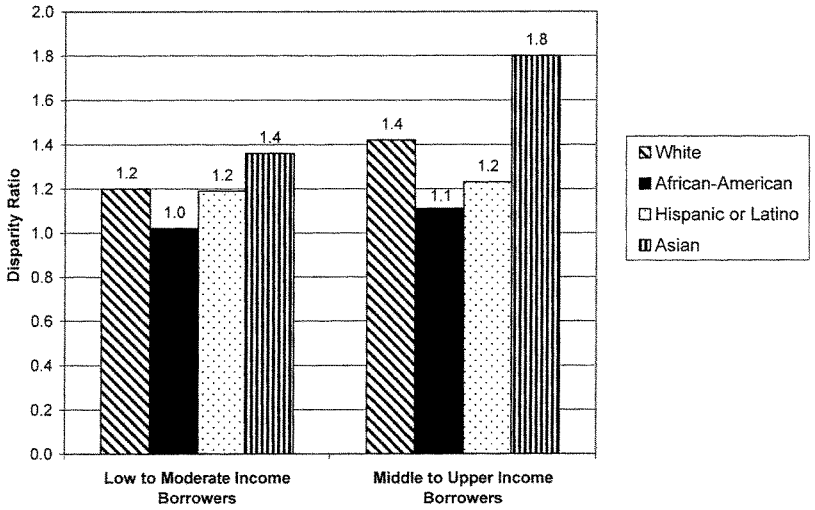
Within the races, the disparity in subprime market share of loans to females relative to males increased for MUI borrowers as opposed to LMI borrowers. For instance, subprime loans were 23.4 percent of the loans to LMI Hispanic males and 23.8 percent of the loans to LMI Hispanic females. However, subprime loans constituted 20.6 percent of the home purchase loans to MUI Hispanic females and 17.5 percent of loans to MUI

Hispanic males. Likewise, subprime loans made up 6.4 percent of the loans to LMI male Asians and 7.6 percent of the loans to LMI female Asians. For MUI borrowers, subprime loans were 7.2 percent of the loans to Asian females and just 4.9 percent of the loans to Asian males. The subprime market share of loans was 1.5 times greater for MUI female Asians than for MUI male Asians. For LMI borrowers, the difference in market share was a ratio of 1.2. In other words, disparities in subprime market share by gender increased as borrower income level increased.

Conventional Refinance Lending

Just as with home purchase lending, the racial disparities in subprime market share for conventional refinance loans increased with increases in borrower income. For instance, subprime loans were 41.4 percent of all refinance loans to LMI African-American males and just 18.8 percent of the loans to LMI white males (see Table 3B). The subprime market share to LMI African-American males was 2.2 times greater than the subprime market share to LMI white males. In contrast, the subprime market share to MUI African-American males was 2.8 times higher than the subprime market share to MUI white males. Subprime loans comprised 28.9 percent of all refinance loans to MUI African-American males, but were just 10.3 percent of all loans to MUI white males.

Graph 19: Refinance Lending-
Gender Disparities in Subprime Market Share Relative to Males
Females by Borrower Race and Income



Note: For each race and income group, the subprime market share to females is divided by the subprime market share to males.

The gender difference in subprime market share also jumped when considering middle- and upper-income borrowers as opposed to low- and moderate-income borrowers. Subprime loans were 9.9 percent of all refinance loans to LMI female Asians and 7.3 percent of the loans to LMI male Asians. Subprime market share of loans to LMI female Asians was 1.4 times larger than subprime market share to LMI males. In contrast, subprime market share to MUI Asian females was 1.8 times greater than subprime market share to MUI males. Subprime loans were 8.3 percent of refinance loans to MUI Asian females but just 4.6 percent of the loans to MUI Asian males.

Overall, female borrowers were more likely than male borrowers to receive subprime loans. Subprime loans made up 20.9 percent of the refinance loans to females of all racial groups, and were 14.5 percent of the loans to males. The subprime market share to females was 1.4 times greater than the subprime market share to males.

Conventional Home Improvement Lending

Conventional home improvement lending exhibited trends similar to refinance and home purchase lending. Like the other loan types, the racial disparities in subprime market share jumped for middle- and upper-income borrowers versus low- and moderate-income borrowers. In addition, the gender disparities in subprime market share also widened as income level increased. The notable difference between home improvement lending and the other types of lending was that overall subprime market shares were higher. For instance, subprime loans were 41.9 percent and 43.5 percent of all home improvement loans to African-American males and females respectively (see Table 3C). In contrast, subprime loans constituted 31 percent and 34 percent of all home purchase loans to African-American males and females, respectively.

As with the other types of lending, subprime market share was higher to females as opposed to males of all races. Subprime lending accounted for 26.4 percent of the home improvement loans to females and 20.5 percent of the loans to males. The same disparities held for home purchase and refinance lending, but the subprime market shares were lower for home purchase and refinance lending than for home improvement lending. For instance, subprime loans were 14.3 percent of the home purchase loans to females and 10.6 percent of the purchase loans to males of all races. Subprime market share to males and females for home improvement lending was almost twice that of subprime market shares for home purchase lending.

Recommendations

Only comprehensive and collaborative action by all stakeholders can meaningfully reduce lending disparities identified in this report. Lenders, community groups, and public officials must work together to develop best industry practices and policy solutions for ensuring equal access to credit for all Americans. Below is a list of programmatic and policy recommendations.

Recommendations for Consumers and Community Groups

Shop Around for Best Loan Terms and Conditions

Buying a home is the only form of wealth building for most Americans. Consumers should enter in a loan transaction exceedingly carefully, regardless of whether consumers are buying homes for the first time, refinancing their loans, or taking out home equity loans. Generally speaking, consumers should obtain price quotes from three different lenders, and preferably more. Consumers should carefully query lenders about loan terms and conditions, including the amount of fees in the loans, any penalties applied for paying off the loan before the end of its term, and insurance and other products financed in the loan amount. If consumers are unsure concerning loan terms and conditions, they should consult reputable counseling agencies. NCRC can provide consumers with referrals to quality counseling agencies.

Community Groups Should Use the New HMDA Data

NCRC member organizations and community organizations around the country should use the new HMDA data to monitor lender performance in offering reasonable prices to traditionally underserved communities and borrowers. When community organizations notice glaring price disparities for a particular lender or group of lenders, they should bring these disparities to the attention of regulatory agencies. At the same time, community organizations should establish partnerships with responsible prime and subprime lenders that are seeking to genuinely increase product choice and price competition in traditionally underserved communities. The new data can be used by partnerships of lenders and community groups to identify neighborhoods with concentrations of high cost loans; these neighborhoods are ripe for more competition among lenders.

Community Groups Should Develop Best Practices and Products with Industry

The national dialogue among NCRC member organizations, community organizations, and the lending industry has been vital for promoting industry reforms, programs, and best practices. A number of egregious practices in the subprime industry including single premium credit insurance, onerous prepayment penalties and mandatory arbitration have been abandoned by major subprime lenders. In addition, large lenders that have prime and subprime companies are working towards ensuring that borrowers are provided full product choice. When borrowers approach the subprime outlet of a lender, the borrower needs to receive a prime loan if the borrower is qualified for a prime loan. Lenders are in the process of developing these "referral up" programs, making sure that borrowers are not inappropriately steered to subprime loans and receive prime loans when they qualify. More work needs to be done on these "referral up" mechanisms, but the community-lender dialogue has been important for the progress made to date.

Recommendations: Legislative & Regulatory

Enhance the Quality of HMDA Data

Congress and the Federal Reserve Board (which implements the HMDA regulations) must enhance HMDA data so that regular and comprehensive studies can scrutinize fairness in lending. Specifically, are minorities, the elderly, women, and low- and moderate-income borrowers and communities able to receive loans that are fairly priced? More information in HMDA data is critical to fully explore the intersection of price, race, gender, and income. HMDA data must contain credit score information. For each HMDA reportable loan, a financial institution must indicate whether it used a credit score system and if the system was their own or one of the widely used systems such as FICO (a new data field in HMDA could contain 3 to 5 categories with the names of widely-used systems). The HMDA data also would contain one more field indicating which quintile of risk the credit score system placed the borrower. In addition, HMDA data must contain information on other key underwriting variables including the loan-to-value and debt-to-income ratios.

Using these data, regulators, researchers, the media, and the public could determine if any of the credit score systems were placing minorities and other protected classes in the higher risk categories a disproportionate amount of time. The data would facilitate more econometric analysis to assess whether the prices of loans are based on risk, race, gender, or age.

Federal Reserve Board Must Step Up Anti-Discrimination and Fair Lending Oversight

The Government Accountability Office concluded that the Federal Reserve Board has the authority to conduct fair lending reviews of affiliates of bank holding companies. The Federal Reserve Board, however, continues to insist that it lacks this authority.[16] This issue must be resolved because comprehensive anti-discrimination exams of all parts of bank holding companies are critical. Most of the major banks have acquired large subprime lenders that are then considered affiliates and become off-limits to Federal Reserve examination. A pressing question is the extent to which the subprime affiliates refer creditworthy customers to the prime parts of the bank so that the customers receive loans at prevailing rates instead of higher subprime rates. Or does the subprime affiliate steer creditworthy borrowers to high cost loans? These questions remain largely unanswered. Consequently, we do not know the extent of steering by subprime affiliates and/or their parent banks. Thus, it is past time for the Federal Reserve to examine affiliates as well as the parent bank.

Comprehensive Anti-Predatory Lending Legislation

Since our analysis revealed a disproportionate amount of subprime lending targeted to vulnerable borrowers and communities, Congress must respond by enacting

[16] Government Accountability Office, *Large Bank Mergers: Fair Lending Review Could be Enhanced with Better Coordination*, November 1999, GAO/GGD-00-16.

comprehensive anti-predatory lending legislation along the lines of bills introduced by Representatives Watt, Miller, and Frank and Senator Sarbanes. Comprehensive and strong anti-predatory lending legislation would eliminate the profitability of exploitative practices by making them illegal. It could also reduce the amount of price discrimination since fee packing and other abusive practices would be prohibited. A comprehensive anti-predatory law would also strengthen the Community Reinvestment Act (CRA) if regulatory agencies severely penalize lenders through failing CRA ratings when the lenders violate anti-predatory law.

Stop Regulators from Weakening CRA

CRA imposes an affirmative and continuing obligation on banks to serve the credit needs of all communities, including low- and moderate-income neighborhoods. Federal examiners issue a publicly available rating to banks with assets over $250 million based on how many loans, investments, and services they make to low- and moderate-income neighborhoods. The three part CRA exam (lending, investment, and service tests) for institutions with more than $250 million in assets has been instrumental in increasing access to loans, investments, and services for residents in low- and moderate-income communities.

However, the Office of Thrift Supervision (OTS) eliminated the investment and service tests for savings and loans with assets between $250 million and $1 billion. Eliminating these tests means that thrifts will no longer have the incentive to make investments in affordable housing, such as Low-Income Housing Tax Credits, and will no longer be scrutinized by examiners on how many branches and affordable banking services they are making available in low- and moderate-income neighborhoods. CRA also took a further blow from the OTS when that agency most recently ruled to allow thrifts with over $1 billion in assets to choose whether they even want to undergo the investment and service tests, thus giving them the power to pick and choose which community needs they will meet. Yet another change from the FDIC, Federal Reserve Board, and the Office of the Comptroller of the Currency diluted CRA exams for banks with assets between $250 million and $1 billion.

Given the persistence of disparities by income and race as illustrated in this study, it is counterproductive to lessen CRA oversight. If CRA oversight continues to diminish, the level of abusive lending to vulnerable populations is likely to increase even further as traditional lenders reduce the number of branches, bank products, and affordable housing investments in low- and moderate-income communities. Instead, regulators must strengthen CRA exams and hold lenders accountable to communities.

Strengthen CRA by Applying It to Minority Neighborhoods and All Geographical Areas Lenders Serve

In order to increase prime lending for minority borrowers and reduce lending disparities, CRA exams must evaluate the banks' records of lending to minority borrowers and neighborhoods as well as scrutinizing banks' performance in reaching low- and

moderate-income borrowers and neighborhoods. CRA's mandate of affirmatively meeting credit needs is currently incomplete as it is now applies only to low- and moderate-income neighborhoods, not minority communities.

CRA must also be strengthened so that depository institutions undergo CRA examinations in all geographical areas in which they make a significant number of loans. Currently, CRA exams assess lending primarily in geographical areas in which banks have their branches. But the overlap between branching and lending is eroding with each passing year as lending via brokers and correspondents continues to increase. A solution to this is modernizing CRA. The CRA Modernization Act, HR 865 introduced in the 107th Congress, mandates that banks undergo CRA exams in geographical areas in which their market share of loans exceeds one half of one percent in addition to areas in which their branches are located.

Short of statutory changes to CRA, the regulatory agencies have the authority to extend CRA examinations and scrutiny to geographical areas beyond narrow "assessment" areas in which branches are located. Currently, the federal banking agencies will consider lending activity beyond assessment areas if the activity will enhance CRA performance. Likewise, the CRA rating must be downgraded if the lending performance in reaching low- and moderate-income borrowers is worse outside than inside the assessment areas.

CRA Exams Must Scrutinize Subprime Lending More Rigorously

Currently, CRA exams are not adequately assessing the CRA performance of subprime lenders. For example, the CRA exam of the subprime lender, Superior Bank, FSB, called its lending innovative and flexible before that thrift's spectacular collapse.[17] Previous NCRC comment letters to the regulators have documented cursory fair lending reviews for the great majority of banks and thrifts involved in subprime lending.[18] If CRA exams continue to mechanistically consider subprime lending, subprime lenders will earn good ratings since they usually offer a larger portion of their loans to low- and moderate-income borrowers and communities than prime lenders.

The federal agencies have just amended the CRA regulations so that banks will be downgraded if their lending violates federal anti-predatory law. Prior to this recent change, fair lending reviews that accompany CRA exams have not usually scrutinized subprime lending for compliance with anti-predatory law, for possible pricing discrimination, or whether abusive loans are exceeding borrower ability to repay. All CRA exams of lenders with significant subprime lending volumes must be accompanied by a comprehensive fair lending and anti-predatory lending audit. In addition, CRA exams must ensure that prime lenders are not financing predatory lending through their secondary market activity or servicing abusive loans.

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[17] Office of Thrift Supervision Central Region's CRA Evaluation of Superior Bank, FSB, Docket #: 08566, September 1999. Available via http://www.ots.treas.gov, go to the CRA search engine and select "inactive" for the status of the institution being searched.

[18] NCRC comment letter to federal banking agencies on joint CRA proposal, April 2, 2004. Available via: http://www.ncrc.org.

GSEs Must Abide by Anti-Predatory Safeguards

The Government-Sponsored Enterprises (GSEs), including Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, purchase more than half of the home loans made on an annual basis in this country. It is vitally important, therefore, that the GSEs have adopted adequate protections against purchasing predatory loans. Fannie Mae and Freddie Mac have voluntarily adopted significant protections such as purchasing no loans with fees exceeding five percent of the loan amount, no loans involving price discrimination or steering, no loans with prepayment penalties beyond three years, and no loans with mandatory arbitration. The Department of Housing and Urban Development (HUD) has ruled that Fannie Mae and Freddie Mac will not receive credit towards their Affordable Housing Goals for any loans that contain certain abusive features.

HUD's ruling is an important first step, but it needs to be enhanced. HUD's ruling, for example, does not include disqualification from goals consideration of loans with mandatory arbitration. Congress has an opportunity to further bolster the anti-predatory protections applied to GSE loan purchasing activity as Congress considers GSE regulatory reform.

Methodology

NCRC used the 2004 HMDA data and 2000 Census for the report. As described above in the executive summary, this report considered subprime loans to be loans with price reporting.

Comparing Percent of Loans to Borrowers to Percent of Households or Owner-Occupied Housing Units

This part of the analysis focused on breaking down the data by prime and subprime loans and compared the lending data to corresponding demographic data.

- Specifications for the HMDA lending data included: loan type; 1st lien or 2nd lien (depending on the analysis); single family units only (no multifamily units); originated; no transition application; and owner-occupied only.
- Lending data is broken down by borrower race, borrower income, borrower gender, minority level of census tract, and income level of census tract. Lending data for each category was calculated by dividing the number of loans to each group by the denominator described for the following groups:
    - Borrower Race: Total *loans* minus loans to *joint(interracial co-borrowers)* and loans in which the *race of the borrower was not available*. (Use for all groups under Borrower Race, except for *Hispanic or Latino*. For the denominator for *Hispanic or Latino,* use total *loans* minus *joint* and *ethnicity not available.*
    - Borrower Income: Total *loans* minus *income not available for borrowers.*
    - Borrower Gender: Total *loans* minus *gender not available.*
    - Minority Level of Census Tract: Total *loans.*

- Income Level of Census Tract: Total *loans* minus *income of census tract not available*

- Demographic data for each category were calculated by dividing the number of households in each group by the denominator described for the following groups:
  - Borrower Race: Total households minus *other race only* households. (Use for all groups under Borrower Race, including *Hispanic or Latino*.)
  - Borrower Income: Total households.
  - Borrower Gender: Total households. For the numerator, female or male households are single females or males or female headed or male headed households.
  - Minority Level of Census Tract: Total owner-occupied housing units.
  - Income Level of Census Tract: Total owner-occupied housing units.

Below is an example of how to interpret the data. These figures can be verified in Table 1A by reviewing row 3 under Borrower Race and the last row labeled Total:

- In the United States in 2004, African-Americans received 161,571, or 5.5%, of all 3,325,201 prime home purchase loans made to all borrowers. African-Americans also received 75,937, or 20.1%, of all 433,902 subprime home purchase loans made to all borrowers. Reviewing all loans together (prime plus subprime), lenders made only 237,508, or 7.2%, of all 3,759,103 home purchase loans to African-Americans. African-Americans, however, made up 12,023,812, or 11.8% of households in the United States in 2004.

Subprime Market Share Analysis

Race by Borrower Income – Data is cross tabulated by borrower race (*American Indian/Alaska Native*; *Asian*; *Black or African American*; etc.) and borrower income (*LMI* or *MUI*), so that data reflects loans made to borrowers of various races but same income levels (ex. Asian MUI borrower or White Non-Hispanic MUI Borrower). On the tables, below the rows labeled *Count*, are *Market Share %* and *Disparity Ratio to Whites* rows.

- Market Share % describes the percent of subprime loans made to a borrower group compared to all loans made to the borrower group. It is calculated by dividing the number of subprime loans made to a specific borrower group by the number of prime plus subprime loans made to the same group.

Equation:

$$\frac{\text{\# of Subprime Loans to Specific Group}}{(\text{\# of Prime Loans to Specific Group} + \text{\# of Subprime Loans to Specific Group})}.$$

- Disparity Ratio to Whites describes the lending disparity between the subprime market share for one racial group of borrowers (such as American Indians or Hispanics) compared to the market share for white borrowers. It is calculated by dividing the market share percentage for the non-white borrower group by the market share percentage for White Non-Hispanic borrowers. Disparity ratios hold borrower

income constant, and therefore allow for additional light to be shed on how borrowers are treated according to their race. For example, this chart allows researchers to observe lending patterns to low- and moderate-income African-Americans compared to low- and moderate-income White Non-Hispanics.

Equation:

$$\frac{\text{Subprime Market Share for Non-White borrower group}}{\text{Subprime Market Share for White Non-Hispanic group}}$$

Below is an example of how to interpret the data. These figures can be verified in Table 2A by reviewing the *LMI Borrower* row and the *Black or African American* column:

- In the United States in 2004, lenders made 34,300 subprime home purchase loans to African-American LMI borrowers (see where the *LMI Borrowers* row and the *Black or African American* column intersect). Subprime lending accounted for 39.0% of all loans to African-American LMI borrowers. This percentage is calculated by dividing 34,300 subprime loans by 34,300 subprime loans + 53,544 prime loans (the number of prime loans is not shown in the market share tables). Comparatively, subprime home purchase loans made up 12.6% of the loans to White Non-Hispanic LMI borrowers. By dividing the subprime market share percentage for African-American LMI borrowers by the market share percentage for White Non-Hispanic LMI borrowers (39% divided by 12.6%), the disparity ratio illustrates that lenders made subprime home purchase loans to African-American LMI borrowers 3.1 times more often as to White Non-Hispanic LMI borrowers.

Race-Gender by Borrower Income – Data are cross tabulated by borrower race, borrower gender, and borrower income, so that the data reflect loans made to borrowers of race and gender combinations holding income levels constant (e.g. number of loans to *MUI African-American male borrowers*; *MUI African-American female borrowers*; *LMI Hispanic male borrowers*; *LMI Hispanic female borrowers*)

- Market Share % is calculated the same as above.
- Gender Disparity Ratio analyzes the disparities between the subprime market share for men and women. It is calculated by dividing the subprime market share percentage for women by the market share percentage for men.
- Race Disparity Ratio analyzes the lending disparities between the subprime market share for non-white borrower groups and the market share for White Non-Hispanic borrowers. It is calculated by dividing the subprime market share percentage for the non-white borrower group by the subprime market share percentage for White Non-Hispanic borrowers.

Below is an example of how to interpret the data. These figures can be verified in Table 3B by reviewing the *LMI Borrower* row, the *African-American Male* and *African-American Female* columns, and the *White Non-Hispanic Male* and *Female* columns:

- Lenders made 26,917 subprime refinance loans to African-American LMI male borrowers and 40,454 subprime refinance loans to African-American LMI female borrowers. These numbers accounted for 41.4% and 42.3% of the loans to African-American LMI male and African-American LMI female borrowers. Comparing the subprime market shares for African-American LMI females (42.3%) and for white non-Hispanic LMI females (22.5%) illustrates that lenders made subprime refinance loans to African-American LMI females 1.9 times more often than to their white counterparts. Similarly, lenders made subprime refinance loans to African-American LMI males 2.2 times more often than to their white counterparts.

Tract Race by Borrower Income – Data is cross tabulated by borrower income and census tract race (substantially minority, immigrant, or not substantially minority or white), so that data reflects loans made to borrowers of both categories (ex. LMI borrowers in not substantially minority census tracts).

- Market Share % is calculated the same as above.
- Race Disparity Ratio analyzes the lending disparities between the subprime market share for substantially minority or immigrant tracts and the market share for not substantially minority census tracts. It is calculated by dividing the subprime market share percentage for the substantially minority or immigrant census tracts by the market share percentage for not substantially minority or white census tracts.

Below is an example of how to interpret the data. These figures can be verified in Table 4D by reviewing the *MUI Borrower* row and the *Substantially Minority* column:

- Lenders made 222,222 subprime all single-family loans to *MUI borrowers* in *Substantially Minority* census tracts, which accounted for 18.6% of all loans to MUI borrowers in minority tracts. (This was calculated by dividing 222,222 subprime all single-family loans to *MUI* borrowers in *Substantially Minority* census tracts by the 222,222 subprime and the 971,142 prime all single-family loans made to *MUI* borrowers in *Substantially Minority* census tracts. The number of prime loans is not shown in the market share tables.)

APPENDICES

NCRC Portfolio Share Analysis: Home Purchase Lending - Conventional

2004 National Peer Mortgage Data

TABLE 1A

	Prime Loans		Subprime Loans		All Loans		Demographic Data	
	Count	%	Count	%	Count	%	Count	%
Borrower Race								
American Indian/Alaska Native	24,779	0.8%	5,296	1.4%	30,075	0.9%	770,162	0.76%
Asian	188,691	6.4%	11,840	3.1%	200,531	6.1%	3,128,368	3.08%
Black or African American	161,571	5.5%	75,937	20.1%	237,508	7.2%	12,023,812	11.82%
Native Hawaiian / Other Pacific Islander	17,235	0.6%	3,205	0.8%	20,440	0.6%	100,151	0.10%
Hispanic or Latino	330,498	11.4%	80,625	21.3%	411,123	12.5%	9,270,778	9.12%
White Non-Hispanic	2,160,699	73.7%	203,541	53.9%	2,364,240	71.4%	78,967,522	77.64%
Minorities, including Hispanic	776,204	26.5%	177,613	47.1%	953,817	28.8%	26,571,600	26.13%
Borrower Income								
Low (0-49% of Median)	185,689	5.86%	41,458	9.9%	227,147	6.3%	24,300,179	23.02%
Moderate (50-79% of Median)	601,323	19.0%	118,471	28.4%	719,794	20.1%	17,476,772	16.56%
Middle (80-119% of Median)	854,765	27.0%	128,247	30.8%	983,012	27.4%	20,261,598	19.20%
Upper (>=120% of Median)	1,524,910	48.2%	128,661	30.9%	1,653,571	46.1%	43,481,518	41.20%
Borrower Gender								
Male	1,020,244	31.9%	180,345	42.7%	1,200,589	33.2%	19,441,896	18.42%
Female	766,043	24.0%	135,576	32.1%	901,619	24.9%	30,638,775	29.03%
Joint	1,411,890	44.1%	106,490	25.2%	1,518,380	41.9%	55,458,451	52.55%
Tract Characteristics								
Substantially Minority	498,205	15.0%	123,047	28.4%	621,252	16.5%	10,764,953	15.42%
Immigrant	94,676	2.85%	8,379	1.93%	103,055	2.7%	782,196	1.12%
Not Substantially Minority	2,794,221	84.0%	306,610	70.7%	3,100,831	82.5%	59,038,519	84.58%
Low (0-49% of Median)	43,067	1.3%	14,475	3.4%	57,542	1.5%	1,151,371	1.65%
Moderate (50-79% of Median)	374,218	11.4%	95,930	22.3%	470,148	12.6%	10,499,381	15.04%
Middle (80-119% of Median)	1,558,556	47.4%	227,022	52.8%	1,785,578	48.0%	38,188,082	54.71%
Upper (>=120% of Median)	1,315,701	40.0%	92,171	21.5%	1,407,872	37.8%	19,964,638	28.60%
Total	3,325,201	100.0%	433,902	100.0%	3,759,103	100.0%	105,539,122	

NCRC Portfolio Share Analysis: Home Improvement Lending - Conventional

2004 National Peer Mortgage Data

TABLE 1B

	Prime Loans		Subprime Loans		All Loans		Demographic Data	
	Count	%	Count	%	Count	%	Count	%
Borrower Race								
American Indian/Alaska Native	3,279	1.41%	1,032	1.57%	4,311	1.44%	770,162	0.76%
Asian	8,183	3.52%	753	1.14%	8,936	2.99%	3,128,368	3.08%
Black or African American	16,235	6.97%	11,902	18.05%	28,137	9.42%	12,023,812	11.82%
Native Hawaiian / Other Pacific Islander	1,854	0.80%	401	0.61%	2,255	0.75%	100,151	0.10%
Hispanic or Latino	30,121	13.03%	9,958	15.10%	40,079	13.49%	9,270,778	9.12%
White Non-Hispanic	171,222	73.56%	42,316	64.19%	213,538	71.49%	78,967,522	77.64%
Minorities, including Hispanic	62,711	26.94%	24,339	36.92%	87,050	29.14%	26,571,600	26.13%
Borrower Income								
Low (0-49% of Median)	26,715	10.34%	13,034	17.73%	39,749	11.98%	24,300,179	23.02%
Moderate (50-79% of Median)	53,865	20.85%	20,872	28.39%	74,737	25.02%	17,476,772	16.56%
Middle (80-119% of Median)	71,421	27.65%	20,784	28.27%	92,205	30.87%	20,261,598	19.20%
Upper (>=120% of Median)	106,305	41.15%	18,840	25.62%	125,145	41.90%	43,481,518	41.20%
Borrower Gender								
Male	58,446	23.03%	20,243	27.92%	78,689	24.12%	19,441,896	18.42%
Female	58,410	23.02%	21,507	29.66%	79,917	24.50%	30,638,775	29.03%
Joint	136,889	53.95%	30,754	42.42%	167,643	51.38%	55,458,451	52.55%
Tract Characteristics								
Substantially Minority	57,789	21.74%	23,071	30.91%	80,860	23.75%	10,764,953	15.42%
Immigrant	12,260	4.61%	1,038	1.39%	13,298	3.91%	782,196	1.12%
Not Substantially Minority	204,784	77.05%	50,697	67.92%	255,481	75.05%	59,038,519	84.58%
Low (0-49% of Median)	5,048	1.92%	2,995	4.01%	8,043	2.39%	1,151,371	1.65%
Moderate (50-79% of Median)	40,727	15.51%	18,379	24.62%	59,106	17.57%	10,499,381	15.04%
Middle (80-119% of Median)	138,682	52.82%	40,838	54.71%	179,520	53.38%	38,188,082	54.71%
Upper (>=120% of Median)	78,107	29.75%	11,553	15.48%	89,660	26.66%	19,964,638	28.60%
Total	265,789	100.00%	74,642	100.00%	340,431	100.00%	105,539,122	

NCRC Portfolio Share Analysis: Refinance Lending - Conventional

2004 National Peer Mortgage Data

TABLE 1C

	Prime Loans		Subprime Loans		All Loans		Demographic Data	
	Count	%	Count	%	Count	%	Count	%
Borrower Race								
American Indian/Alaska Native	38,287	0.9%	9,507	1.3%	47,794	1.0%	770,162	0.76%
Asian	195,831	4.8%	12,285	1.7%	208,116	4.3%	3,128,368	3.08%
Black or African American	260,864	6.4%	136,071	19.0%	396,935	8.2%	12,023,812	11.82%
Native Hawaiian / Other Pacific Islander	26,470	0.6%	5,199	0.7%	31,669	0.7%	100,151	0.10%
Hispanic or Latino	427,719	10.6%	97,830	13.7%	525,549	11.0%	9,270,778	9.12%
White Non-Hispanic	3,067,700	74.9%	451,564	62.9%	3,519,264	73.1%	78,967,522	77.64%
Minorities, including Hispanic	1,026,076	25.0%	266,585	37.1%	1,292,661	26.8%	26,571,600	26.13%
Borrower Income								
Low (0-49% of Median)	300,805	6.7%	106,388	12.2%	407,193	7.6%	24,300,179	23.02%
Moderate (50-79% of Median)	878,345	19.4%	247,296	28.4%	1,125,641	20.9%	17,476,772	16.56%
Middle (80-119% of Median)	1,280,622	28.4%	271,739	31.2%	1,552,361	28.8%	20,261,598	19.20%
Upper (>=120% of Median)	2,056,329	45.5%	246,458	28.3%	2,302,787	42.7%	43,481,518	41.20%
Borrower Gender								
Male	1,176,404	25.7%	263,617	31.0%	1,440,021	26.5%	19,441,896	18.42%
Female	997,576	21.8%	244,199	28.7%	1,241,775	22.9%	30,638,775	29.03%
Joint	2,404,912	52.5%	342,859	40.3%	2,747,771	50.6%	55,458,451	52.55%
Tract Characteristics								
Substantially Minority	867,327	17.9%	251,475	28.4%	1,118,802	19.5%	10,764,953	15.42%
Immigrant	185,097	3.82%	12,700	1.43%	197,797	3.5%	782,196	1.12%
Not Substantially Minority	3,932,643	81.2%	628,397	70.9%	4,561,040	79.6%	59,038,519	84.58%
Low (0-49% of Median)	57,821	1.2%	26,813	3.0%	84,634	1.5%	1,151,371	1.65%
Moderate (50-79% of Median)	580,572	12.1%	199,848	22.7%	780,420	13.7%	10,499,381	15.04%
Middle (80-119% of Median)	2,358,956	49.1%	483,973	55.0%	2,842,929	50.1%	38,188,082	54.71%
Upper (>=120% of Median)	1,802,258	37.6%	169,208	19.2%	1,971,466	34.7%	19,964,638	28.60%
Total	4,841,076	100.0%	886,536	100.0%	5,727,612	100.0%	105,539,122	

NCRC Portfolio Share Analysis: All Single-Family Lending - Conventional

2004 National Peer Mortgage Data

TABLE 1D

	Prime Loans		Subprime Loans		All Loans		Demographic Data	
	Count	%	Count	%	Count	%	Count	%
Borrower Race								
American Indian/Alaska Native	66,345	0.91%	15,835	1.36%	82,180	0.97%	770,162	0.76%
Asian	392,705	5.41%	24,878	2.14%	417,583	4.95%	3,128,368	3.08%
Black or African American	438,670	6.04%	223,910	19.29%	662,580	7.86%	12,023,812	11.82%
Native Hawaiian / Other Pacific Islander	45,559	0.63%	8,805	0.76%	54,364	0.64%	100,151	0.10%
Hispanic or Latino	788,338	10.96%	188,413	16.30%	976,751	11.70%	9,270,778	9.12%
White Non-Hispanic	5,399,621	74.35%	697,421	60.07%	6,097,042	72.30%	78,967,522	77.64%
Minorities, including Hispanic	1,864,991	25.68%	468,537	40.36%	2,333,528	27.67%	26,571,600	26.13%
Borrower Income								
Low (0-49% of Median)	513,209	6.46%	160,880	11.81%	674,089	7.25%	24,300,179	23.02%
Moderate (50-79% of Median)	1,533,533	19.31%	386,639	28.38%	1,920,172	20.64%	17,476,772	16.56%
Middle (80-119% of Median)	2,206,808	27.79%	420,770	30.89%	2,627,578	28.24%	20,261,598	19.20%
Upper (>=120% of Median)	3,687,544	46.44%	393,959	28.92%	4,081,503	43.87%	43,481,518	41.20%
Borrower Gender								
Male	2,255,094	28.08%	464,205	34.50%	2,719,299	29.00%	19,441,896	18.42%
Female	1,822,029	22.69%	401,282	29.82%	2,223,311	23.71%	30,638,775	29.03%
Joint	3,953,691	49.23%	480,103	35.68%	4,433,794	47.29%	55,458,451	52.55%
Tract Characteristics								
Substantially Minority	1,423,321	16.88%	397,593	28.50%	1,820,914	18.53%	10,764,953	15.42%
Immigrant	292,033	3.46%	22,117	1.59%	314,150	3.20%	782,196	1.12%
Not Substantially Minority	6,931,648	82.21%	985,704	70.66%	7,917,352	80.57%	59,038,519	84.58%
Low (0-49% of Median)	105,936	1.27%	44,283	3.20%	150,219	1.54%	1,151,371	1.65%
Moderate (50-79% of Median)	995,517	11.92%	314,157	22.71%	1,309,674	13.45%	10,499,381	15.04%
Middle (80-119% of Median)	4,056,194	48.56%	751,833	54.35%	4,808,027	49.38%	38,188,082	54.71%
Upper (>=120% of Median)	3,196,066	38.26%	272,932	19.73%	3,468,998	35.63%	19,964,638	28.60%
Total	8,432,066	100.00%	1,395,080	100.00%	9,827,146	100.00%	105,539,122	

NCRC Portfolio Share Analysis: All Single-Family Lending - Government Insured

2004 National Peer Mortgage Data

TABLE 1E

	Prime Loans		Subprime Loans		All Loans		Demographic Data	
	Count	%	Count	%	Count	%	Count	%
Borrower Race								
American Indian/Alaska Native	7,490	1.13%	472	5.13%	7,962	1.19%	770,162	0.76%
Asian	7,619	1.15%	233	2.53%	7,852	1.17%	3,128,368	3.08%
Black or African American	108,204	16.34%	1,402	15.23%	109,606	16.32%	12,023,812	11.82%
Native Hawaiian / Other Pacific Islander	3,857	0.58%	161	1.75%	4,018	0.60%	100,151	0.10%
Hispanic or Latino	92,576	14.01%	2,102	22.76%	94,678	14.13%	9,270,778	9.12%
White Non-Hispanic	435,628	65.78%	4,942	53.69%	440,570	65.62%	78,967,522	77.64%
Minorities, including Hispanic	238,736	36.05%	4,431	48.14%	243,167	36.22%	26,571,600	26.13%
Borrower Income								
Low (0-49% of Median)	66,241	12.18%	1,136	13.98%	67,377	12.21%	24,300,179	23.02%
Moderate (50-79% of Median)	194,113	35.69%	2,951	36.31%	197,064	35.70%	17,476,772	16.56%
Middle (80-119% of Median)	179,532	33.01%	2,628	32.34%	182,160	33.00%	20,261,598	19.20%
Upper (>=120% of Median)	103,997	19.12%	1,412	17.37%	105,409	19.10%	43,481,518	41.20%
Borrower Gender								
Male	233,988	32.28%	3,209	31.20%	237,197	32.27%	19,441,896	18.42%
Female	163,228	22.52%	2,656	25.82%	165,884	22.57%	30,638,775	29.03%
Joint	327,611	45.20%	4,420	42.98%	332,031	45.17%	55,458,451	52.55%
Tract Characteristics								
Substantially Minority	145,892	19.53%	2,948	27.91%	148,840	19.65%	10,764,953	15.42%
Immigrant	5,332	0.71%	105	0.99%	5,437	0.72%	782,196	1.12%
Not Substantially Minority	584,855	78.30%	7,444	70.47%	592,299	78.19%	59,038,519	84.58%
Low (0-49% of Median)	11,207	1.53%	218	2.10%	11,425	1.54%	1,151,371	1.65%
Moderate (50-79% of Median)	132,009	18.07%	2,386	22.96%	134,395	18.14%	10,499,381	15.04%
Middle (80-119% of Median)	428,752	58.68%	5,646	54.34%	434,398	58.62%	38,188,082	54.71%
Upper (>=120% of Median)	158,701	21.72%	2,140	20.60%	160,841	21.70%	19,964,638	28.60%
Total	746,930	100.00%	10,564	100.00%	757,494	100.00%	105,539,122	

NCRC Portfolio Share Analysis: Manufactured, All Single-Family Lending - Conventional

2004 National Peer Mortgage Data

TABLE 1F

	Prime Manufactured ASF		Subprime Manufactured ASF		All Manufactured ASF		Demographic Data	
	Count	%	Count	%	Count	%	Count	%
Borrower Race								
American Indian/Alaska Native	669	0.88%	1,175	1.36%	1,844	1.14%	770,162	0.76%
Asian	341	0.45%	452	0.52%	793	0.49%	3,128,368	3.08%
Black or African American	2,069	2.72%	5,978	6.93%	8,047	4.96%	12,023,812	11.82%
Native Hawaiian / Other Pacific Islander	159	0.21%	282	0.33%	441	0.27%	100,151	0.10%
Hispanic or Latino	4,134	5.55%	6,197	7.37%	10,331	6.51%	9,270,778	9.12%
White Non-Hispanic	66,278	87.03%	69,219	80.28%	135,497	83.44%	78,967,522	77.64%
Minorities, including Hispanic	8,559	11.24%	14,854	17.23%	23,413	14.42%	26,571,600	26.13%
Borrower Income								
Low (0-49% of Median)	13,044	16.28%	21,304	23.11%	34,348	19.93%	24,300,179	23.02%
Moderate (50-79% of Median)	25,024	31.23%	31,441	34.11%	56,465	32.77%	17,476,772	16.56%
Middle (80-119% of Median)	24,152	30.14%	23,839	25.86%	47,991	27.85%	20,261,598	19.20%
Upper (>=120% of Median)	17,900	22.34%	15,601	16.92%	33,501	19.44%	43,481,518	41.20%
Borrower Gender								
Male	22,180	27.53%	29,310	32.77%	51,490	30.29%	19,441,896	18.42%
Female	17,204	21.35%	23,002	25.72%	40,206	23.65%	30,638,775	29.03%
Joint	41,181	51.12%	37,120	41.51%	78,301	46.06%	55,458,451	52.55%
Tract Characteristics								
Substantially Minority	4,806	5.79%	9,691	10.15%	14,497	8.12%	10,764,953	15.42%
Immigrant	112	0.13%	281	0.29%	393	0.22%	782,196	1.12%
Not Substantially Minority	75,428	90.81%	82,376	86.26%	157,804	88.37%	59,038,519	84.58%
Low (0-49% of Median)	189	0.24%	500	0.54%	689	0.40%	1,151,371	1.65%
Moderate (50-79% of Median)	11,724	14.61%	15,892	17.26%	27,616	16.03%	10,499,381	15.04%
Middle (80-119% of Median)	58,862	73.36%	65,721	71.39%	124,583	72.31%	38,188,082	54.71%
Upper (>=120% of Median)	9,457	11.79%	9,950	10.81%	19,407	11.26%	19,964,638	28.60%
Total	83,062	100.00%	95,500		178,562		105,539,122	

NCRC Portfolio Share Analysis: Second-Lien All Single-Family Lending

2004 National Peer Mortgage Data

TABLE 1G

	Prime Loans		Subprime Loans		All Loans		Demographic Data	
	Count	%	Count	%	Count	%	Count	%
Borrower Race								
American Indian/Alaska Native	8,551	1.0%	5,398	1.4%	13,949	1.1%	770,162	0.76%
Asian	35,088	4.0%	14,786	3.9%	49,874	4.0%	3,128,368	3.08%
Black or African American	49,992	5.7%	57,404	15.3%	107,396	8.5%	12,023,812	11.82%
Native Hawaiian / Other Pacific Islander	5,958	0.7%	4,373	1.2%	10,331	0.8%	100,151	0.10%
Hispanic or Latino	86,642	9.9%	85,187	22.6%	171,829	13.8%	9,270,778	9.12%
White Non-Hispanic	675,518	76.4%	211,187	56.4%	886,705	70.4%	78,967,522	77.64%
Minorities, including Hispanic	207,957	23.5%	170,330	45.5%	378,287	30.1%	26,571,600	26.13%
Borrower Income								
Low (0-49% of Median)	40,598	3.9%	19,717	4.4%	60,315	4.1%	24,300,179	23.02%
Moderate (50-79% of Median)	166,596	16.2%	93,591	21.0%	260,187	17.6%	17,476,772	16.56%
Middle (80-119% of Median)	297,323	28.9%	147,342	33.1%	444,665	30.2%	20,261,598	19.20%
Upper (>=120% of Median)	524,987	51.0%	184,429	41.4%	709,416	48.1%	43,481,518	41.20%
Borrower Gender								
Male	261,972	26.5%	164,983	37.9%	426,955	30.0%	19,441,896	18.42%
Female	189,363	19.1%	118,434	27.2%	307,797	21.6%	30,638,775	29.03%
Joint	538,026	54.4%	152,448	35.0%	690,474	48.4%	55,458,451	52.55%
Tract Characteristics								
Substantially Minority	152,516	14.3%	122,515	26.8%	275,031	18.0%	10,764,953	15.42%
Immigrant	35,814	3.35%	10,010	2.19%	45,824	3.0%	782,196	1.12%
Not Substantially Minority	900,601	84.3%	331,841	72.5%	1,232,442	80.8%	59,038,519	84.58%
Low (0-49% of Median)	12,353	1.2%	10,604	2.3%	22,957	1.5%	1,151,371	1.65%
Moderate (50-79% of Median)	116,031	11.0%	86,209	19.0%	202,240	13.4%	10,499,381	15.04%
Middle (80-119% of Median)	526,803	50.0%	242,524	53.4%	769,327	51.0%	38,188,082	54.71%
Upper (>=120% of Median)	397,773	37.8%	114,975	25.3%	512,748	34.0%	19,964,638	28.60%
Total	1,068,470	100.0%	457,556	100.0%	1,526,026	100.0%	105,539,122	

NCRC Market Share Analysis: Subprime Lending, Conventional - Race by Borrower Income

2004 National Peer Mortgage Data

TABLE 2A

	Borrower Race						
Subprime Home Purchase	**American Indian/ Alaska Native**	**Asian**	**Black or African American**	**Native Hawaiian/ Other Pacific Islander**	**Hispanic or Latino**	**White Non-Hispanic**	**Minorities, Including Hispanic**
LMI Borrowers							
Count	1,723	2,372	34,300	891	25,504	76,276	64,302
Market Share %	21.5%	6.9%	39.0%	19.9%	23.5%	12.6%	26.3%
Disparity Ratio to Whites	1.707	0.547	3.101	1.582	1.869	1.000	2.086
MUI Borrowers							
Count	3,359	8,832	39,766	2,204	51,712	119,242	107,134
Market Share %	16.4%	5.6%	28.4%	14.7%	18.4%	7.2%	16.1%
Disparity Ratio to Whites	2.273	0.783	3.933	2.037	2.558	1.000	2.238
Total							
Count	5,082	11,204	74,066	3,095	77,216	195,518	171,436
Market Share %	17.8%	5.9%	32.5%	15.9%	19.9%	8.7%	8.9%
Disparity Ratio to Whites	2.060	0.678	3.753	1.836	2.295	1.000	1.034

NCRC Market Share Analysis: Subprime Lending, Conventional - Race by Borrower Income

2004 National Peer Mortgage Data

TABLE 2B

	Borrower Race						
Subprime Refinance	American Indian/ Alaska Native	Asian	Black or African American	Native Hawaiian/ Other Pacific Islander	Hispanic or Latino	White Non-Hispanic	Minorities, Including Hispanic
LMI Borrowers							
Count	3,666	2,906	67,741	1,645	35,842	174,802	111,544
Market Share %	23.5%	8.4%	41.9%	20.6%	22.1%	19.2%	50.0%
Disparity Ratio to Whites	1.22	0.44	2.19	1.07	1.15	1.00	2.61
MUI Borrowers							
Count	5,706	9,124	66,422	3,494	60,552	269,606	151,234
Market Share %	19.0%	5.7%	30.2%	15.7%	17.9%	11.3%	17.9%
Disparity Ratio to Whites	1.688	0.501	2.676	1.392	1.590	1.000	1.585
Total							
Count	9,372	12,030	134,163	5,139	96,394	444,408	262,778
Market Share %	20.6%	6.1%	35.2%	17.0%	19.3%	13.5%	21.4%
Disparity Ratio to Whites	1.53	0.46	2.61	1.26	1.43	1.00	1.59

NCRC Market Share Analysis: Subprime Lending, Conventional - Race by Borrower Income

2004 National Peer Mortgage Data

TABLE 2C

	Borrower Race						
Subprime Home Improvement	American Indian/ Alaska Native	Asian	Black or African American	Native Hawaiian/ Other Pacific Islander	Hispanic or Latino	White Non-Hispanic	Minorities, Including Hispanic
LMI Borrowers							
Count	430	223	6,562	151	3,969	19,126	11,278
Market Share %	27.87%	12.33%	48.26%	23.59%	29.93%	26.47%	36.84%
Disparity Ratio to Whites	1.05	0.47	1.82	0.89	1.13	1.00	1.39
MUI Borrowers							
Count	590	520	5,241	247	5,925	22,459	12,869
Market Share %	22.01%	7.56%	37.33%	15.79%	22.82%	16.53%	23.55%
Disparity Ratio to Whites	1.33	0.46	2.26	0.96	1.38	1.00	1.42
Total							
Count	1,020	743	11,803	398	9,894	41,585	24,147
Market Share %	24.15%	8.55%	42.71%	18.06%	25.22%	19.98%	28.32%
Disparity Ratio to Whites	1.21	0.43	2.14	0.90	1.26	1.00	1.42

NCRC Market Share Analysis: Subprime Lending, Conventional - Race by Borrower Income

2004 National Peer Mortgage Data

TABLE 2D

Subprime All Single-Family	Borrower Race						
	American Indian/ Alaska Native	Asian	Black or African American	Native Hawaiian/ Other Pacific Islander	Hispanic or Latino	White Non-Hispanic	Minorities, Including Hispanic
LMI Borrowers							
Count	5,819	5,501	108,603	2,687	65,315	270,204	187,124
Market Share %	23.11%	7.77%	41.30%	20.49%	23.04%	17.00%	28.42%
Disparity Ratio to Whites	1.36	0.46	2.43	1.21	1.35	1.00	1.67
MUI Borrowers							
Count	9,655	18,476	111,429	5,945	118,189	411,307	271,237
Market Share %	18.17%	5.69%	29.78%	15.32%	18.36%	9.84%	17.34%
Disparity Ratio to Whites	1.85	0.58	3.03	1.56	1.86	1.00	1.76
Total							
Count	15,474	23,977	220,032	8,632	183,504	681,511	458,361
Market Share %	19.76%	6.06%	34.53%	16.62%	19.79%	11.82%	20.62%
Disparity Ratio to Whites	1.67	0.51	2.92	1.41	1.67	1.00	1.75

NCRC Market Share Analysis: Subprime Lending, Conventional - Race-Gender by Borrower Income

2004 National Peer Mortgage Data

TABLE 3A

Subprime Home Purchase	Black or African American		Hispanic or Latino (Ethnicity)		Asian		White Non-Hispanic (Minority Status)		Total	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
LMI Borrowers										
Count	14,348	19,761	16,576	8,842	1,324	1,022	44,857	31,244	87,164	68,582
Market Share %	39.74%	38.49%	23.41%	23.75%	6.37%	7.56%	12.92%	12.14%	16.60%	17.39%
Gender Disparity Ratio*	0.97		1.01		1.19		0.94		1.05	
Race Disparity Ratio**	3.08	3.17	1.81	1.96	0.49	0.62	1.00	1.00	1.29	1.43
MUI Borrowers										
Count	22,253	17,337	34,165	17,326	5,287	3,488	85,223	33,752	168,082	82,168
Market Share %	27.25%	29.94%	17.51%	20.60%	4.91%	7.24%	6.76%	8.69%	8.95%	12.51%
Gender Disparity Ratio	1.10		1.18		1.48		1.29		1.40	
Race Disparity Ratio	4.03	3.44	2.59	2.37	0.73	0.83	1.00	1.00	1.32	1.44
Total										
Count	36,601	37,098	50,741	26,168	6,611	4,510	130,080	64,996	255,246	150,750
Market Share %	31.08%	33.96%	19.08%	21.56%	5.15%	7.31%	8.09%	10.06%	10.62%	14.34%
Gender Disparity Ratio	1.09		1.13		1.42		1.24		1.35	
Race Disparity Ratio	3.84	3.37	2.36	2.14	0.64	0.73	1.00	1.00	1.31	1.42

TABLE 3B

Subprime Refinance	Black or African American		Hispanic or Latino (Ethnicity)		Asian		White Non-Hispanic (Minority Status)		Total	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
LMI Borrowers										
Count	26,917	40,454	21,909	13,737	1,475	1,392	98,024	90,414	179,884	159,101
Market Share %	41.36%	42.31%	20.78%	24.66%	7.25%	9.88%	18.77%	22.54%	21.79%	24.98%
Gender Disparity Ratio	1.02		1.19		1.36		1.20		1.15	
Race Disparity Ratio	2.20	1.88	1.11	1.09	0.39	0.44	1.00	1.00	1.16	1.11
MUI Borrowers										
Count	37,508	28,559	41,030	19,219	5,326	3,713	191,937	76,914	338,799	159,278
Market Share %	28.94%	32.09%	16.87%	20.72%	4.60%	8.27%	10.33%	14.66%	12.27%	17.90%
Gender Disparity Ratio	1.11		1.23		1.80		1.42		1.46	
Race Disparity Ratio	2.80	2.19	1.63	1.41	0.45	0.56	1.00	1.00	1.19	1.22
Total										
Count	64,425	69,013	62,939	32,956	6,801	5,105	289,961	167,328	518,683	318,379
Market Share %	33.09%	37.38%	18.05%	22.19%	5.00%	8.66%	12.18%	18.08%	14.46%	20.86%
Gender Disparity Ratio	1.13		1.23		1.73		1.48		1.44	
Race Disparity Ratio	2.72	2.07	1.48	1.23	0.41	0.48	1.00	1.00	1.19	1.15

* Gender Disparity Ratio describes the difference in lending patterns between males and females. In this chart, gender disparity ratios specifically describe the differences between black male borrowers and black female borrowers; between Hispanic male borrowers and Hispanic female borrowers; and between white male borrowers and white female borrowers.

** Race Disparity Ratio describes the difference in lending patterns within gender between whites and black borrowers; and between white and Hispanic borrowers.

NCRC Market Share Analysis: Subprime Lending, Conventional - Race-Gender by Borrower Income

2004 National Peer Mortgage Data

TABLE 3C

Subprime Home Improvement	Black or African American		Hispanic or Latino (Ethnicity)		Asian		White Non-Hispanic (Minority Status)		Total	
	Male	Female	Male	Female	Male	Female	Male	Female	Males	Females
LMI Borrowers										
Count	2,697	3,837	2,401	1,548	116	107	10,431	8,661	17,290	15,628
Market Share %	49.16%	47.63%	28.69%	32.10%	11.63%	13.31%	26.08%	26.92%	28.71%	31.11%
Gender Disparity Ratio	0.97		1.12		1.14		1.03		1.08	
Race Disparity Ratio	1.89	1.77	1.10	1.19	0.45	0.49	1.00	1.00		
MUI Borrowers										
Count	3,003	2,214	3,960	1,929	290	227	16,205	6,219	26,480	12,043
Market Share %	36.95%	37.79%	21.36%	26.55%	6.36%	9.87%	15.64%	19.37%	17.28%	22.08%
Gender Disparity Ratio	1.02		1.24		1.55		1.24		1.28	
Race Disparity Ratio	2.36	1.95	1.37	1.37	0.41	0.51	1.00	1.00		
Total										
Count	5,700	6,051	6,361	3,477	406	334	26,636	14,880	43,770	27,671
Market Share %	41.87%	43.49%	23.64%	28.76%	7.30%	10.76%	18.55%	23.15%	20.51%	26.41%
Gender Disparity Ratio	1.04		1.22		1.47		1.25		1.29	
Race Disparity Ratio	2.26	1.88	1.27	1.24	0.39	0.47	1.00	1.00		

TABLE 3D

Subprime All Single-Family	Black or African American		Hispanic or Latino (Ethnicity)		Asian		White Non-Hispanic (Minority Status)		Total	
	Male	Female	Male	Female	Male	Female	Male	Female	Males	Females
LMI Borrowers										
Count	43,962	64,052	40,886	24,127	2,915	2,521	153,312	116,193	284,338	243,311
Market Share %	41.21%	41.32%	22.14%	24.68%	6.92%	8.87%	16.86%	17.17%	20.15%	22.50%
Gender Disparity Ratio	1.00		1.11		1.28		1.02		1.12	
Race Disparity Ratio	2.44	2.41	1.31	1.44	0.41	0.52	1.00	1.00		
MUI Borrowers										
Count	62,764	48,110	79,155	38,474	10,903	7,428	293,365	116,885	533,361	253,489
Market Share %	28.61%	31.49%	17.32%	20.89%	4.78%	7.79%	9.10%	12.37%	11.13%	15.83%
Gender Disparity Ratio	1.10		1.21		1.63		1.36		1.42	
Race Disparity Ratio	3.14	2.55	1.90	1.69	0.53	0.63	1.00	1.00		
Total										
Count	106,726	112,162	120,041	62,601	13,818	9,949	446,677	233,078	817,699	496,800
Market Share %	32.73%	36.44%	18.71%	22.21%	5.12%	8.04%	10.81%	14.37%	13.18%	18.52%
Gender Disparity Ratio	1.11		1.19		1.57		1.33		1.41	
Race Disparity Ratio	3.03	2.54	1.73	1.54	0.47	0.56	1.00	1.00		

* Gender Disparity Ratio describes the difference in lending patterns between males and females. In this chart, gender disparity ratios specifically describe the differences between black male borrowers and black female borrowers; between Hispanic male borrowers and Hispanic female borrowers; and between white male borrowers and white female borrowers.

** Race Disparity Ratio describes the difference in lending patterns within gender between whites and black borrowers; and between white and Hispanic borrowers.

NCRC Market Share Analysis: Subprime Lending, Conventional - Tract Race by Borrower Income

2004 National Peer Mortgage Data

TABLE 4A

Subprime Home Purchase	Tract Race		
	Substantially Minority	Immigrant	Not Substantially Minority
LMI Borrowers			
Count	46,294	997	113,386
Market Share %	28.48%	12.99%	14.49%
Race Disparity Ratio	1.97	0.90	1.00
MUI Borrowers			
Count	73,173	7,110	183,309
Market Share %	16.85%	13.64%	8.34%
Race Disparity Ratio	2.02	1.64	1.00
Total			
Count	119,467	8,107	296,695
Market Share %	20.02%	13.56%	9.96%
Race Disparity Ratio	2.01	1.36	1.00

TABLE 4B

Subprime Refinance	Tract Race		
	Substantially Minority	Immigrant	Not Substantially Minority
LMI Borrowers			
Count	111,891	2,961	241,374
Market Share %	30.95%	14.02%	20.65%
Race Disparity Ratio	1.50	0.68	1.00
MUI Borrowers			
Count	136,967	9,515	380,511
Market Share %	19.32%	13.92%	12.12%
Race Disparity Ratio	1.59	1.15	1.00
Total			
Count	248,858	12,476	621,885
Market Share %	23.25%	13.94%	14.43%
Race Disparity Ratio	1.61	0.97	1.00

* The ratio indicates the lending disparity between predominately white census tracts and substantially minority or immigrant census tracts.

NCRC Market Share Analysis: Subprime Lending, Conventional - Tract Race by Borrower Income

2004 National Peer Mortgage Data

TABLE 4C

Subprime Home Improvement	Tract Race		
	Substantially Minority	Immigrant	Not Substantially Minority
LMI Borrowers			
Count	10,875	295	22,929
Market Share %	37.08%	18.61%	27.05%
Race Disparity Ratio	1.37	0.69	1.00
MUI Borrowers			
Count	12,082	739	27,415
Market Share %	24.12%	16.93%	16.49%
Race Disparity Ratio	1.46	1.03	1.00
Total			
Count	22,957	1,034	50,344
Market Share %	28.91%	17.38%	20.05%
Race Disparity Ratio	1.44	0.87	1.00

TABLE 4D

Subprime All Single-Family	Tract Race		
	Substantially Minority	Immigrant	Not Substantially Minority
LMI Borrowers			
Count	169,060	4,253	377,689
Market Share %	30.55%	14.00%	18.55%
Race Disparity Ratio	1.65	0.75	1.00
MUI Borrowers			
Count	222,222	17,364	591,235
Market Share %	18.62%	13.91%	10.74%
Race Disparity Ratio	1.73	1.29	1.00
Total			
Count	391,282	21,617	968,924
Market Share %	22.40%	13.93%	12.85%
Race Disparity Ratio	1.74	1.08	1.00

* The ratio indicates the lending disparity between predominately white census tracts and substantially minority or immigrant census tracts.

The 2005 Fair Lending Disparities: Stubborn and Persistent II

May 2006
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The National Community Reinvestment Coalition

The National Community Reinvestment Coalition (NCRC) is the nation's trade association for economic justice whose members consist of local community based organizations. Since its inception in 1990, NCRC has spearheaded the economic justice movement. NCRC's mission is to build wealth in traditionally underserved communities and bring low- and moderate-income populations across the country into the financial mainstream. NCRC members have constituents in every state in America, in both rural and urban areas.

The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication and serve as a resource to all of us in the public and private sector who are committed to responsible lending. For more information, please contact:

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We would also like to thank our contractor, the KRA Corporation, for their timely and tireless work on this project.

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Abstract

NCRC's survey of 17 large lending institutions includes a substantial share of the total lending market for 2005, perhaps up to one third of the loans reported by institutions in HMDA (Home Mortgage Disclosure Act) data. The previous HMDA data for 2004 revealed that lending institutions issued 1.4 million conventional high-cost loans and 8.4 million market-rate loans. Our sample using the 2005 data includes 1.4 million high-cost loans and 3.5 million market-rate conventional loans. High-cost lending was a much higher portion of overall lending in 2005, climbing from 12.2 percent of total loans in 2004 to 28.2 percent of total loans in 2005. As described below, it is difficult to disentangle data reporting issues from economic events to account for the surge in high-cost lending reported in 2005.

Minorities, women, and low- and moderate-income borrowers across the United States of America receive a disproportionate amount of high cost loans. Across the country, African-Americans received 16.8 percent of the conventional high-cost loans but only 5.5 percent of the conventional market-rate loans during 2005. In contrast, whites received a greater percentage of market-rate than high-cost loans. Whites received 67.4 percent and 51.8 percent of the market-rate and high-cost loans, respectively. Disparities are also present by gender. Females received 37.3 percent of the high-cost conventional loans but just 28 percent of the market-rate conventional loans in NCRC's sample of 2005 loans. Males, in contrast, received a higher percentage of market-rate loans (66.8 percent) than high-cost loans (60.2 percent).

Low-income and even middle-income borrowers received substantial amounts of high-cost loans. Of all the conventional loans made to low- and moderate-income and middle-income borrowers, between 39 to 45 percent were high cost. In contrast, of all the conventional loans made to upper-income borrowers, 24.4 percent were high-cost. The disparities by income level were among the greatest disparities only to be surpassed by the African-American/white disparity. Of all the conventional loans made to African-Americans, 54.5 percent were high-cost. In contrast, of all the conventional loans issued to whites, 23.3 percent were high-cost. Hispanics and Native Americans also received a disproportionate amount of high-cost loans. About 40.7 percent and 35 percent of the conventional loans made to Hispanics and Native Americans, respectively, were high-cost loans. Disparities in very high-cost HOEPA lending were particularly worrisome for African-Americans and women.

Similar disparities were found when analyzing refinance, home purchase, and home improvement lending separately. Large disparities were also found in manufactured housing and subordinate lien loans. For example, of all the manufactured housing loans made to African-Americans, an incredible 75.8 percent were high cost. Lastly, just like last year, the report finds that higher levels of high-cost lending occurred when borrowers requested preapprovals for home purchase loans than when they did not request preapprovals. Finally, intensified enforcement is needed but has been missing. We do not know what happened last year after the Federal Reserve identified the need to further investigate 200 large lenders. The disparities remain serious as revealed by the new data.

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The 2005 Fair Lending Disparities: Stubborn and Persistent II

Executive Summary

This is the second year NCRC has conducted a study shortly after the release of the most recent home loan data. Because fair lending disparities have not narrowed from last year, we are using the same title for this year's report: *The 2005 Fair Lending Disparities: Stubborn and Persistent II.*

Minorities, women, and low- and moderate-income borrowers across the United States of America receive a disproportionate amount of high cost loans. This is the second year in which the Home Mortgage Disclosure Act data (HMDA) contains information on pricing for high cost loans. In previous years, the general public had to rely on a list of subprime lending specialists from the Department of Housing and Urban Development (HUD) in order to determine patterns of high cost lending.[1] This year, the data has more precision. Yet, the fact remains that fair lending disparities by race, gender, and income remain stubborn and persistent. This was true in the 2004 HMDA data and is also true in the new 2005 HMDA, which first became available in April of this year.

Prime loans are loans made at prevailing interest rates to borrowers with good credit histories. Subprime loans, in contrast, are loans with rates higher than prevailing rates made to borrowers with credit blemishes. The higher rates compensate lenders for the added risks of lending to borrowers with credit blemishes. While responsible subprime lending serves credit needs, public policy concerns arise when certain groups in the population receive a disproportionate amount of subprime loans. When subprime lending crowds out prime lending in traditionally underserved communities, price discrimination and other predatory and deceptive practices become more likely as residents face fewer product choices.

For the year 2005, it is unclear if there is an exact correspondence between loans with price information and subprime loans. The federal financial regulatory agencies caution that changes in short- and long-term rates have likely increased the number and percentages of loans with pricing information.[2] It is possible, therefore, that some loans with price information are prime loans, though they probably have interest rates that place them among the more expensive of prime loans and close to subprime loans in price. This report indeed finds that the number and percentage of loans with pricing information has increased significantly. To avoid equating all loans with price information as subprime loans, this report adopts the names "high-cost" loans as loans with price information and "market-rate" loans as loans without price information. However, the same concerns about a disproportionate amount of high-cost loans received

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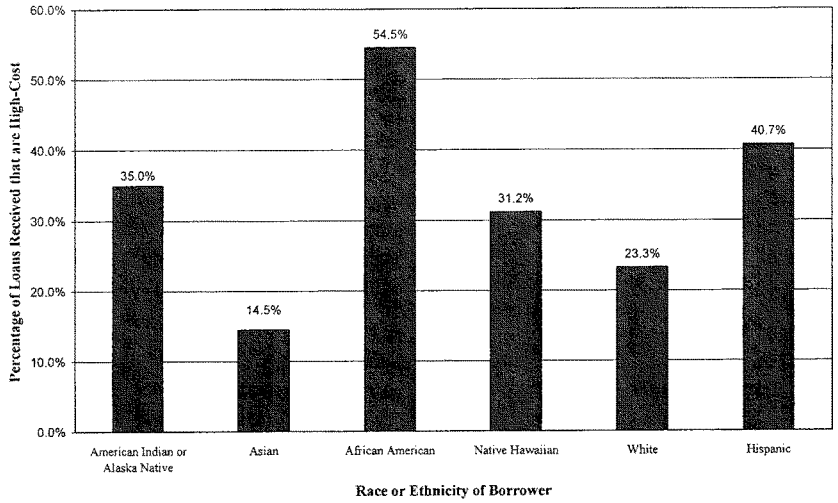
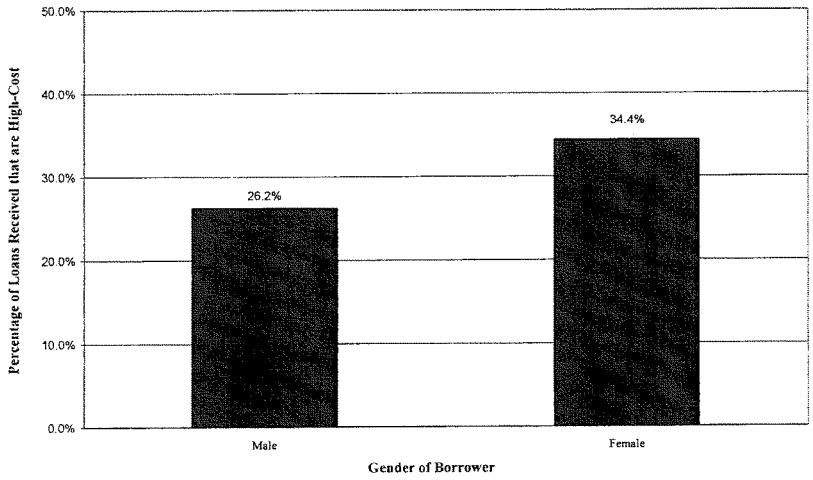
[1] HUD refines its lists on an annual basis. HUD's web page (http://www.huduser.org/datasets/manu.html) has more information about the lists and has copies of the lists.

[2] Frequently Asked Questions About the New HMDA Data, http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20060403/attachment.pdf

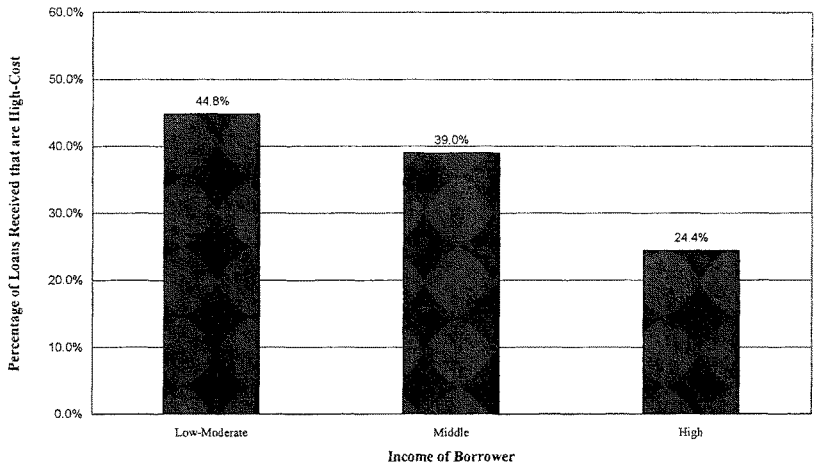
Minorities Receive Disproportionate Amount of High-Cost Loans



Women Receive Disproportionate Amount of High-Cost Loans



High-Cost Lending Prevalent Among Low-Moderate & Middle-Income Borrowers



by certain borrower groups still apply. If certain groups in the population received a disproportionate amount of high-cost loans, then either price discrimination and/or market failure may be preventing these borrower groups from having a greater variety of product choice and range of prices.

NCRC's survey of 17 large lending institutions for 2005 includes a substantial share of the total lending market, perhaps up to one third of the loans reported by institutions in HMDA data. The previous HMDA data for 2004 revealed that lending institutions issued 1.4 million conventional high-cost loans and 8.4 million market-rate loans. Our sample using the 2005 data includes 1.4 million high-cost loans and 3.5 million market-rate conventional loans. High-cost lending was a much higher portion of overall lending in 2005, climbing from 12.2 percent of total loans in NCRC's sample with the 2004 data to 28.2 percent of total loans in the 2005 sample.

Minorities, women, and low- and moderate-income borrowers across the United States of America receive a disproportionate amount of high cost loans. Across the country, African-Americans received 16.8 percent of the conventional high-cost loans but only 5.5 percent of the conventional market-rate loans during 2005. In contrast, whites received a greater percentage of market-rate than high-cost loans. Whites received 67.4 percent and 51.8 percent of the market-rate and high-cost loans, respectively. Disparities are also present by gender. Females received 37.3 percent of the high-cost conventional loans but just 28 percent of the market-rate conventional loans in NCRC's sample of 2005 loans. Males, in contrast, received a higher percentage of market-rate loans (66.8 percent) than high-cost loans (60.2 percent).

Of all the conventional loans made to low- and moderate-income and middle-income borrowers, between 39 to 45 percent were high cost. It is significant that high-cost lending was high even for middle-income borrowers, at 39 percent of all the loans they received. In contrast, of all the conventional loans made to upper-income borrowers, 24.4 percent were high-cost. The disparities by income level were among the greatest disparities only to be surpassed by the African-American/white disparity. Of all the conventional loans made to African-Americans, 54.5 percent were high-cost. In contrast, of all the conventional loans issued to whites, 23.3 percent were high-cost. Hispanics and Native Americans also received a disproportionate amount of high-cost loans. About 40.7 percent and 35 percent of the conventional loans made to Hispanics and Native Americans, respectively, were high-cost loans.

Similar disparities were found when analyzing refinance, home purchase, and home improvement lending separately. Large disparities were also found in manufactured housing and subordinate lien loans. For example, of all the manufactured housing loans made to African-Americans, an incredible 75.8 percent were high-cost. Manufactured housing lending is disproportionately high-cost lending; even 47.2 percent of manufactured housing loans received by whites in NCRC's 2005 sample were high-cost.

Disparities in lending were particularly worrisome for African-Americans and women for very high-cost loans covered by the Home Ownership and Equity Protection Act (HOEPA). African-Americans were the only racial group to receive a substantially higher percentage of very high-cost loans than market-rate loans. Likewise, women, in contrast to men, obtained a higher percentage of very high-cost loans than market-rate loans.

Just like last year, this report found a higher level of high-cost lending when borrowers requested preapprovals for home purchase loans than when preapprovals were not requested. Not only were levels of high-cost lending higher when preaprovals were requested, but racial and income disparities were just as significant when preapprovals were requested. This is contrary to expectations since the common belief is that preapprovals are used by savvy borrowers to help them bid in the housing market. The persistence of this finding calls for further federal agency investigations into the use of preapprovals. Are preapprovals used by savvy borrowers or are they more of a quick sell tactic by brokers and loan officers to hook borrowers into high cost loans?

Much has already been written about how the new HMDA data, by itself, cannot prove the existence of discrimination. Observers, including the federal banking agencies, note that HMDA data omits key underwriting variables including borrower creditworthiness, loan-to-value ratios, and debt-to-income ratios. NCRC and our 600 member organizations had advocated for the inclusion of these data elements so that HMDA data would be most useful for identifying the complete causes of pricing disparities. But the absence of the key underwriting variables does not reduce the data to little value. The regulatory agencies themselves note that the new price data is a "useful screen, previously unavailable, to identify lenders, products, applicants, and geographic markets

where price differences among racial or other groups are sufficiently large to warrant further investigation."[3]

NCRC will be one of the stakeholders using the new HMDA data to conduct further investigations and pursue enforcement options when warranted. In the meantime, the presence of disparities means that all stakeholders (responsible lenders, community organizations, and public officials) have our work cut out for us in increasing access to affordable loans for traditionally underserved populations.

No stakeholder can be complacent. The fact that the new 2005 data shows similar disparities to earlier years suggests that after controlling for creditworthiness and other key underwriting variables, discrimination is a likely contributor to the disparities. In a previous report, *The Broken Credit System*, NCRC obtained creditworthiness data on a one time basis and combined it with 2001 HMDA data.[4] We found that after controlling for creditworthiness, housing characteristics, and economic conditions the number of subprime loans increased markedly in minority and elderly neighborhoods in ten large metropolitan areas. Our study revealing pricing disparities even controlling for creditworthiness was consistent with an analysis conducted by a Federal Reserve economist.[5]

Since disparities with the new 2005 data remain stubborn and persistent, we believe that a good chance exists that troubling indications of discrimination will still be revealed in further studies that combine the 2005 HMDA data with other datasets containing key underwriting variables. Furthermore, NCRC and other researchers will further probe whether the overall increase in high-cost lending is an artifact of the convergence of long- and short-term interest rates or whether economic factors or underwriting practices also account for the substantial surge in high-cost lending. The surge in high-cost lending has certainly caught the attention of stakeholders, and must remain the subject of careful analysis. In addition, high-cost lending was at high levels for middle-income borrowers and women as well during 2005, meaning that fair access and pricing is an issue for a broad segment of the population.

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[3] See Answers to Frequently Asked Questions about HMDA Data, p. 5.

[4] Study is available on the NCRC web page of http://www.ncrc.org or via contacting us on 202-628-8866.

[5] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. See also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622.

List of Lenders

The lenders surveyed for this report are among the largest institutions in the country, and a number of them have significant supbrime operations. In alphabetical order, the lenders are:

Ameriquest
Bank of America
BB&T
Citigroup
Countrywide
HSBC
JP Morgan Chase
Key Bank
National City
New Century
Option One
Suntrust
TD Banknorth
US Bank
Wachovia
Washington Mutual
Wells Fargo

Findings

Conventional Single Family Loans – Table 1

- When considering loans by race, the NCRC sample included 3.6 million market-rate conventional loans without price information and 1.4 million high-cost loans with price spread information. High-cost loans were 28.2 percent of the total conventional loans in the 2005 sample (see Table 1 in the appendix).

- African-Americans received 16.8 percent of the conventional high-cost loans but only 5.5 percent of the conventional market-rate loans during 2005. In contrast, whites received a greater percentage of prime than high-cost loans. Whites received 51.8 percent and 67.4 percent of the high-cost and market-rate loans, respectively.

- Of all the conventional loans made to African-Americans, 54.5 percent or 235,985 were high-cost. In contrast, of all the conventional loans issued to whites, only 23.3 percent were high-cost. Hispanics and Native Americans also experienced more disparities than whites. Of all the conventional loans issued to Hispanics and Native Americans, 40.7 percent and 35.0 percent, respectively, were high-cost. Asians received fewer high-cost loans (only 14.5 percent) as a portion of total conventional loans than whites.

- Disparities were present by gender. Females received 37.3 percent of the high-cost conventional loans but just 28.0 percent of the market-rate conventional loans in NCRC's sample of 2005 loans. Males, in contrast, received a higher percentage of market-rate loans (66.8 percent) than high-cost loans (60.2 percent).

- Of all the conventional loans issued to females, 34.4 percent were high-cost. In contrast, just 26.2 percent of the loans for males were high-cost during 2005.

- When considering borrower income, NCRC used a national median income figure derived from a 2004 Census Bureau survey of about $44,000.[6] We then applied CRA definitions of low- and moderate-income (up to 80 percent of median income), middle-income (81 to 120 percent of median income) and upper or high income of 121 percent or greater of median income. Of all the conventional loans made to low- and moderate-income and middle-income borrowers, between 39.0 to 44.8 percent were high-cost. Even middle-income borrowers received a significant portion of high-cost loans; 39 percent of all loans to middle-income borrowers were high-cost. In contrast, of all the conventional loans made to upper-income borrowers, just 24.4 percent were high-cost. The disparities by

[6]: Historical Income Tables – Households, U.S. Census Bureau, Current Population Survey, 2004. Available online at http://www.census.gov/hhes/www/income/histinc/h06ar.html , last accessed 16 May 2006. NCRC increased the 2004 median income figure by $1,000 to update it for 2005.

income level were among the greatest disparities only to be surpassed by the African-American/white disparity.

- The mean and median price spreads for high-cost loans do not differ that much by race, income, or gender. In 2004, HMDA data for the first time reported how many percentage points an Annual Percentage Rate (APR) of a first lien loan is above the rate of Treasury securities of comparable terms if the spread between the loan and Treasury securities is 3 percentage points or more. In 2005, the median spread for high-cost loans varied by about 40 basis points from 4.4 for Asians on the low end to 4.72 for African Americans and 4.8 for low- and moderate-income borrowers on the high end. The more significant story is the disparity in the portion of high-cost and market-rate loans received by different categories of borrowers than disparities in price spreads in the high-cost loans. When the Federal Reserve Board (FRB) was considering pricing information in HMDA data, NCRC had urged the FRB to include price information for all loans in order to provide the fullest possible picture of price distributions for various categories of borrowers. This initial sample of HMDA data provides information to support NCRC's recommendation concerning pricing information.

Government-Insured Single Family Loans – Table 2

- The NCRC sample contained few high-cost government-insured loans. The lending institutions sampled issued just 790 high-cost government-insured loans while they made 173,288 market-rate government-insured loans when considering loan totals by race.

- Since the great majority of government-insured lending is market-rate lending, Congress and the Department of Housing and Urban Development (HUD) should carefully consider any movement towards risk-based pricing, as is currently being proposed. Preserving affordable alternatives to high-cost lending in the market-place is important in order to maintain competitive pressure on lowering loan prices. Government-insured lending still appears to be relatively affordable and is used to a greater extent by traditionally underserved populations than conventional lending. For example, low- and moderate-income borrowers received 23.5 percent of the market-rate government-insured loans while these borrowers received just 8.2 percent of the market-rate conventional loans during 2005.

Conventional and Government-Insured Single Family Loans – Table 3

- The trends when combining conventional and government-insured loans are very similar to the trends when considering conventional loans by themselves due to the much greater number of conventional loans and conventional high-cost loans than government-insured loans.

Conventional Refinance Single Family Loans – Table 4

- Consistent with previous research, NCRC's sample shows that refinance loans constitute the majority of high-cost loans. High-cost conventional refinance loans were 795,172 or 56.7 percent of the 1,402,805 total high-cost conventional loans in NCRC's 2005 sample.

- African-Americans received 16.2 percent of high-cost refinance loans but only 6.5 percent of market-rate refinance loans. Whites, in contrast, received a higher percentage of market-rate than high-cost refinance loans (67.2 percent versus 54.0 percent).

- Of the total conventional refinance loans received by African-Americans, 52.2 percent were high-cost. In contrast, just 26.0 percent of all refinance loans were high-cost for whites. Hispanics also had a higher portion of high-cost loans than whites at 37.3 percent of all conventional refinance loans received by that ethnic group.

- Females received 38.1 percent of high-cost refinance loans, but just 28.5 percent of market-rate refinance loans. In contrast, males received a higher portion of market-rate than high-cost refinance loans (65.9 percent versus 59.0 percent).

- Of all the refinance loans made to low- and moderate-income and middle-income borrowers, 46.8 and 41.0 percent, respectively, were high-cost. In contrast, just 26.8 percent of conventional refinance loans issued to upper-income borrowers were high-cost during 2005.

Conventional Home Purchase Loans – Table 5

- Lenders in NCRC's 2005 sample made 534,803 conventional high-cost home purchase loans and 1,583,226 conventional market-rate loans.

- African-Americans received 17.4 percent of high-cost home purchase loans but just 4.2 percent of market-rate home purchase loans. Whites, in contrast, received a higher portion of market-rate than high-cost loans (68.1 percent versus 48.3 percent). Hispanics received 22.9 percent of high-cost home purchase loans and 9.4 percent of market-rate home purchase loans.

- Of all the home purchase loans issued to African-Americans, 58.3 percent were high-cost. Only 19.3 percent of conventional home purchase loans for whites were high-cost, but 45.2 percent of home purchase loans for Hispanics were high-cost. Only 14.4 percent of the home purchase loans for Asians were high-cost.

- Females received 35.8 percent of the high-cost home purchase loans but just 27.2 percent of the market-rate home purchase loans. Males enjoyed a higher percentage of market-rate than high-cost loans (68.0 percent versus 62.3 percent).

- Disparities by income levels are significant. Low- and moderate-income borrowers, for example, received 12.9 percent of high-cost home purchase loans but just 6.6 percent of the market-rate loans. Middle-income borrowers received 22.7 percent of high-cost loans but just 14.0 percent of market-rate loans. Upper or high-income borrowers received a much greater portion of market-rate than high-cost loans (79.3 percent as opposed to 64.4 percent).

- Of all the home purchase loans made to low- and moderate-income borrowers, 39.9 percent were high-cost. The comparable figures for middle- and upper-income borrowers were 35.5 percent and just 21.7 percent, respectively.

Conventional Home Improvement Loans – Table 6

- While high-cost home improvement lending is a relatively small portion of overall conventional high-cost lending, a high percentage of home improvement lending is high-cost. Almost 32.3 percent of home improvement lending in our sample was high-cost, compared with 28.2 percent of total conventional lending.

- African-Americans experienced significant disparities in home improvement lending. They received 18.9 percent of high-cost home improvement loans but just 7.9 percent of market-rate home improvement loans. Of all the home improvement loans made to African-Americans, a high 53.5 percent were high-cost. This compares with between 28 and 45 percent of all home improvement loans being high-cost for the other racial groups of borrowers.

- Females received 39.4 percent of high-cost home improvement loans, and a lower percentage (30.8 percent) of market-rate home improvement loans. In contrast, males received a higher percentage of market-rate than high-cost loans. Of all the home improvement loans issued to women, 38.0 percent were high-cost. Just 29.9 percent of all the home improvement loans made to men were high-cost.

- Of all the home improvement loans made to low- and moderate-income borrowers, 51.8 percent were high-cost. For middle- and upper-income borrowers, the figures were 41.1 percent and just 25.5 percent, respectively.

Manufactured Housing – Table 7

- Starting in 2004, HMDA data had another new element in that it has a separate data code indicating if the loan was made to a borrower residing in a manufactured home as opposed to a traditional single family home. Researchers have documented that lending patterns for manufactured homes are different than for traditional single family homes. The 2005 data in this sample confirms that a much higher portion of loans for manufactured homes are high cost loans. Almost 49.3 percent or 27,244 of the loans for manufactured homes were high-cost, in contrast to 28.2 percent of all conventional loans.

- Once again, African-Americans received a disproportionate amount of manufactured housing high-cost loans. Of the manufactured housing loans made to African-Americans, an incredible 75.8 percent were high-cost. This is in sharp contrast to the 36 to 58 percent figure for the other racial groups.

- Not even low- and moderate-income borrowers receive as a high a portion of manufactured housing high-cost loans as African-Americans. Of all the manufactured housing loans made to low- and moderate-income borrowers, 55.0 percent were high-cost. Just 43.5 percent of the manufactured housing loans made to upper-income borrowers were high-cost.

Subordinate Liens – Table 8

- The Federal Reserve Board required lenders to report price information if the spread between the APR on a subordinate lien loan and Treasury securities of comparable terms was 5 percentage points or more. The median spread is between 6 and 7 for most groups of borrowers. On the high end, it is 10.63 for low- and moderate-income borrowers, 6.72 for African-Americans, and 6.61 for Native Americans.

- Overall, median spreads do not reveal much difference in prices of high-cost subordinate lien loans received by various groups of borrowers, except for low- and moderate-income borrowers. The more significant story is the distribution of high-cost subordinate lien loans among different groups of borrowers.

- Subordinate or junior lien loans are typically higher cost than first lien or first mortgage loans. The NCRC 2005 sample bears this out. Of all the subordinate lien loans issued, 45.41 percent or 386,755 were high-cost in contrast to just 28.2 percent of all first lien loans.

- Almost 67 percent of the subordinate lien loans made to African-Americans and 67.3 percent made to Hispanics were high-cost in contrast to 38.7 percent for whites.

- Of all the subordinate lien loans made to females, 51.9 percent were high-cost while the figure for males was 44.4 percent during 2005.

- Fifty seven percent, 54.7 percent, and 42.1 percent of subordinate lien loans for low- and moderate-income, middle-income, and upper-income borrowers, respectively, were high-cost.

Home Purchase Lending, Preapprovals Requested & Not Requested – Tables 9 & 10

- Another rich element of the 2005 data is information on whether preapprovals were requested for home purchase loans. Increasingly, consumers seek

preapprovals in order to increase their chances of winning bidding wars for homes in the strong housing markets of the last several years. Preapprovals are indications from lenders that consumers are likely to be approved for loans, based on summary information such as income levels and home values. Preapprovals are not loan approvals; lenders advise consumers that their actual loan applications may still be denied if further underwriting determines inaccuracies in the initial information or other factors that may disqualify consumers. Nevertheless, consumers typically view preapprovals as a method to speed up the process and assist them in buying homes.

- A striking finding in this study is that pricing disparities are greater on loans in which preapprovals were sought than for home purchase loans in which no preapprovals were requested. In addition, preapprovals are not as widespread as we initially thought. Overall, the sample suggests the great majority of home mortgage loans did not involve preapprovals. More than 946,000 of the loan originations in our sample did not involve preapproval requests whereas just 95,503 did have preapprovals issued. For another 689,930 of the loans in the sample, the lenders indicated that they did not have preapproval programs.

- When preapprovals were requested, 33.9 percent of the home mortgage loans issued to African-Americans was high-cost during 2005 whereas just 10.9 percent of the loans for whites were high-cost. In contrast, when preapprovals were not requested, 26.8 percent of the home mortgage loans for African-Americans were high-cost and 7.9 percent of the loans for whites were high-cost.

- Twenty-four percent of the loans involving preapprovals for Hispanics were high-cost whereas 14.6 percent of the loans not involving preapprovals were high-cost for Hispanics. For Native Americans the disparities were also present: 13.5 percent and 12.3 percent of the loans with and without preapproval requests, respectively, were high-cost.

- The pattern is similar for gender; both men and women are more likely to receive high-cost loans when they request preapprovals. When preapprovals were requested, 16.7 percent and 13.3 percent of the home purchase loans received by women and men, respectively, were high-cost loans. When preapprovals were not requested, 11.2 percent of the loans issued to women were high-cost and 8.7 percent of the loans issued to men were high-cost.

- Lastly, the pattern holds firm when considering income level of borrowers. When preapprovals were requested, 22.6 percent, 21.6 percent, and 10.6 percent of the home purchase loans made to low- and moderate-income borrowers, middle-income borrowers, and upper-income borrowers, respectively, were high-cost. When preapprovals were not requested, 19.4 percent, 14.4 percent, and 6.7 percent of the loans received by low- and

moderate-income borrowers, middle-income borrowers, and upper-income borrowers, respectively, were high-cost.

- We had hoped that disparities would diminish among loans involving preapprovals. NCRC's initial hypothesis was that borrowers more familiar with the home buying and lending process would be using preapprovals, and obtaining favorable rates. On the contrary, some large lenders could be using the preapproval process to quickly lock in home buyers to high cost loans. Lenders could be enticing borrowers with quick preapprovals; borrowers not familiar with loan prices may be grabbing preapprovals rapidly without shopping around for lower rates.

HOEPA Loans – Tables 11, 12, 13

- Starting with the 2004 HMDA data, a new and important data element is an indication of whether a high-cost loan is covered by the Home Ownership and Equity Protection Act (HOEPA). HOEPA is the federal anti-predatory law and applies additional consumer protections to very high cost loans that exceed specified APR and fee thresholds. The current APR threshold is an APR that is 8 percentage points higher than Treasury securities of comparable maturities for a first lien loan and 10 percentage points higher than Treasury securities of comparable maturities for a second lien loan. The fee threshold is 8 percent of the total loan amount.

- The NCRC 2005 sample includes 6,098 HOEPA high-cost loans and 19 market-rate HOEPA loans. A loan can have a market-rate APR but still be a HOEPA loan because fees are high. According to the HMDA data in Table 11, the vast majority of HOEPA loans are covered by HOEPA because of high APRs, not high fees. The mean and median price spreads of high-cost HOEPA loans range from 11 to 14. By race, Native Americans and Native Hawaiians had the highest median price spreads of almost 14.

- African-Americans had 14.3 percent of the HOEPA high-cost loans but only 6.8 percent of non-HOEPA market rate loans during 2005. African-Americans were the only racial group to receive a higher percentage of HOEPA high-cost loans than market-rate loans.

- Females also received a higher percentage of high-cost HOEPA loans (36.7 percent) than non-HOEPA market rate loans (28.5 percent). In contrast, males received a higher percentage of non-HOEPA market-rate loans (65.4 percent) than HOEPA high-cost loans (53.7 percent).

- Low- and moderate-income and middle-income borrowers obtained a higher portion of HOEPA than market-rate loans. For example, low- and moderate-income borrowers received 19.1 percent of the high-cost HOEPA loans but just 9.2 percent of the non-HOEPA market-rate loans during 2005.

Specifications for Data Analysis

Table 1- Conventional, Single Family

Loan Type – Conventional
Property Type – Single Family
Purpose of Loan – Home purchase, home improvement, refinancing
Owner-Occupancy – Owner, non-owner, and NA
Action Taken – Loan originated only
Lien Status – Secured by first lien only.

Table 2 – Government Insured, Single Family

Loan Type – FHA, VA, FSA (All government insured loans)
Property Type – Single Family
Purpose of Loan – Home purchase, home improvement, refinancing
Owner-Occupancy – owner, non-owner, and NA
Action Taken – Loan originated only
Lien Status – Secured by first lien only

Table 3 – Conventional and Government Insured, Single Family

Loan Type – Conventional and government-insured
Property Type – Single Family
Purpose of Loan – Home purchase, home improvement, refinancing
Owner-Occupancy – Owner, non-owner, and NA
Action Taken – Loan originated only
Lien Status – Secured by first lien only

Table 4 – Conventional Refinance Single Family Loans

Loan Type – Conventional
Property Type – Single Family
Purpose of Loan – Refinance
Owner-Occupancy – Owner, non-owner, and NA
Action Taken – Loan originated only
Lien Status – Secured by first lien only

Table 5 – Conventional Home Purchase Single Family Loans

Loan Type – Conventional
Property Type – Single Family
Purpose of Loan – Home purchase
Owner-Occupancy – Owner, non-owner, and NA
Action Taken – Loan originated only
Lien Status – Secured by first lien only

Table 6 – Conventional Home Improvement Single Family Loans

Loan Type – Conventional
Property Type – Single Family
Purpose of Loan – Home Improvement
Owner-Occupancy – Owner, non-owner, and NA
Action Taken – Loan originated only
Lien Status – Secured by first lien only

Table 7 – Manufactured housing

Loan Type – Conventional
Property Type – Manufactured housing
Purpose of Loan – Home purchase, home improvement, refinancing
Owner-Occupancy – Owner, non-owner, and NA
Action Taken – Loan originated only
Lien Status – Secured by first lien only

Table 8 – Subordinate (Second Liens)

Loan Type – Conventional
Property Type – Single Family
Purpose of Loan – Home purchase, refinance, home improvement
Owner-Occupancy – Owner, non-owner, and NA
Action Taken – Loan originated only
Lien Status – Secured by second lien only

Table 9 – Home Purchase Only – Preapproval Requested

Loan Type - Conventional
Property Type - One to four-family (other than manufactured housing)
Loan Purpose - Home purchase only
Action Taken - Loan originated
Lien Status - Secured by a first lien
Owner-Occupancy - Owner-occupied as principal dwelling only
Preapproval (home purchase loans only) - Preapproval was requested

Table 10 – Home Purchase Only – Preapproval Not Requested

Loan Type - Conventional
Property Type - One to four-family (other than manufactured housing)
Loan Purpose - Home purchase only
Action Taken - Loan originated

Lien Status - Secured by a first lien
Owner-Occupancy - Owner-occupied as principal dwelling only
Preapproval (home purchase loans only) - Preapproval was not requested

Tables 11, 12, 13 – HOEPA Loans

Loan Type - Any Type
Property Type - One to four-family or Manufactured housing
Loan Purpose - Home improvement or Refinancing
Action Taken - Loan originated
Owner-Occupancy - Any type
Lien Status - Secured by a first lien or Secured by a subordinate lien

Treatment of Race, Ethnicity, and Gender

All race/ethnic categories, except Black and Hispanic, are "non-Hispanic." Blacks are categorized as Hispanic and non-Hispanic Blacks.

Hispanics in our tables can be of any race except African-Americans. We excluded African-Americans because we wanted mutual exclusive borrower groups for African-Americans and Hispanics.

We coded a loan as made to a particular race (for example, African-Americans) if the primary race (African-American) listed for the borrower was the particular race. HMDA data has five data fields for race of applicant to account for borrowers of multiple races.

Race of borrower was categorized based on the race of the applicant, not the co-applicant. Regarding gender, we used the same procedure regarding co-applicants.

Finally, loan totals by race, income, and gender will differ in some instances because a different number of loans will have missing information for race, income, and gender.

Recommendations: Legislative & Regulatory

Fair Lending Enforcement Must be Increased

Last year, the Federal Reserve Board stated that it referred about 200 lending institutions to their primary federal regulatory agency for further investigations based upon the Federal Reserve's identification of significant pricing disparities in HMDA data.[7] An industry publication subsequently quoted a Federal Reserve official as stating that these lenders accounted for almost 50 percent of the HMDA-reportable loans issued in 2004.[8] After the initial excitement, the public has not heard about the outcomes of the Federal Reserve referrals. Not a single case of discrimination or civil rights violations have arisen from the Federal Reserve's referrals. Given the large share of lending represented by the financial institutions under investigation, the general public should receive an update of the status of these fair lending investigations. Since the pricing disparities remain stubborn and persistent in 2005, fair lending investigations and enforcement must be intensified, yet the general public has received little word regarding the actions of the federal regulatory agencies.

NCRC's report identifies at least two areas that should receive special attention for fair lending investigations. The federal agencies should investigate why pricing disparities are greater when homebuyers request preapprovals than when they do not request preapprovals. Secondly, disparities in very high-cost lending covered by HOEPA must be investigated further. Any discrimination in the application of very high-cost lending can represent serious equity drains and financial devastation suffered by minorities, women, and other protected classes.

Enhance the Quality of HMDA Data

NCRC believes that Congress and the Federal Reserve Board (which implements the HMDA regulations) must enhance HMDA data so that regular and comprehensive studies can scrutinize fairness in lending. Specifically, are minorities, the elderly, women, and low- and moderate-income borrowers and communities able to receive loans that are fairly priced? More information in HMDA data is critical to fully explore the intersection of price, race, gender, and income.

The first area in which HMDA data must be enhanced is pricing information for all loans, not just high-cost loans. The interest rate movements in 2005 demonstrate the confusion associated with classifying the loans that currently have price information reported. Economists as well as the general public do not know whether to call the loans with price reporting, "subprime," "high-cost," or some other name. If price was reported for all loans, the classification problems would be lessened. All stakeholders could review the

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[7] Robert B. Avery, Glenn B. Canner, and Robert E. Cook, *New Information Reported under HMDA and Its Application in Fair Lending Enforcement*, Federal Reserve Bulletin, Summer 2005, http://www.federalreserve.gov/pubs/bulletin/2005/05summerbulletin.htm

[8] Inside Regulatory Strategies, November 14, 2005, p.2.

number and percentages of loans in all the price spread categories. The most significant areas of pricing disparities could be identified with more precision.

Some researchers have already asserted that pricing disparities are worse with the 2005 data than the 2004 data. Assuming this is the case, are pricing disparities worse in the near prime or more expensive prime loans or in the subprime loans? If pricing disparities are more pronounced with the 2005 data, it could be the case that significant pricing disparities in the near prime or more expensive segment of prime loans could be driving the increase in overall disparities. The general public can only guess without having pricing information for all loans. The precision of public scrutiny and fair lending investigations would be enhanced with pricing information on all loans.

HMDA data must contain credit score information similar to the data used in NCRC's *Broken Credit System* report released in the winter of 2003. For each HMDA reportable loan, a financial institution must indicate whether it used a credit score system and if the system was their own or one of the widely used systems such as FICO (a new data field in HMDA could contain 3 to 5 categories with the names of widely-used systems). The HMDA data also would contain one more field indicating which quintile of risk the credit score system placed the borrower.

Another option is to attach credit score information in the form of quintiles to each census tract in the nation. That way, enhanced analyses can be done on a census tract level to see if pricing disparities still remain after controlling for creditworthiness. This was the approach adopted in NCRC's *Broken Credit System* and in studies conducted by Federal Reserve economists. Finally, HMDA data must contain information on other key underwriting variables including the loan-to-value and debt-to-income ratios.

Using this data, regulators, researchers, the media, and the public could determine if any of the credit score systems were placing minorities and other protected classes in the higher risk categories a disproportionate amount of time. The data would facilitate more econometric analysis to assess whether the prices of loans are based on risk, race, gender, or age.

Federal Reserve Board Must Step Up Anti-Discrimination and Fair Lending Oversight

The Government Accountability Office concluded that the Federal Reserve Board has the authority to conduct fair lending reviews of affiliates of bank holding companies. The Federal Reserve Board at first insisted that it lacked this authority, but has recently made some moves to examine affiliates.[9] The Federal Reserve should clarify how and to what extent it is examining affiliates because comprehensive anti-discrimination exams of all parts of bank holding companies are critical. Most of the major banks have acquired large subprime lenders that are then considered affiliates. A pressing question is the extent to which the subprime affiliates refer creditworthy customers to the prime parts of the bank so that the customers receive loans at prevailing rates instead of higher subprime

[9] Government Accountability Office, *Large Bank Mergers: Fair Lending Review Could be Enhanced with Better Coordination*, November 1999, GAO/GGD-00-16.

rates. Or does the subprime affiliate steer creditworthy borrowers to high-cost loans? These questions remain largely unanswered. Consequently, we do not know the extent of steering by subprime affiliates and/or their parent banks.

Comprehensive Anti-Predatory Lending Legislation

Since our analysis revealed a disproportionate amount of high-cost lending targeted to vulnerable borrowers and communities, Congress must respond by enacting comprehensive anti-predatory lending legislation along the lines of bills introduced by Representatives Watt, Miller, and Frank and Senator Sarbanes. Comprehensive and strong anti-predatory lending legislation would eliminate the profitability of exploitative practices by making them illegal. It could also reduce the amount of price discrimination since fee packing and other abusive practices would be prohibited. A comprehensive anti-predatory law would also strengthen the Community Reinvestment Act (CRA) if regulatory agencies severely penalize lenders through failing CRA ratings when the lenders violate anti-predatory law.

Stop Regulators from Weakening CRA

CRA imposes an affirmative and continuing obligation on banks to serve the credit needs of all communities, including low- and moderate-income neighborhoods. Federal examiners issue a publicly available rating to large banks based on how many loans, investments, and services they make to low- and moderate-income neighborhoods. The three part CRA exam (lending, investment, and service tests) for large banks has been instrumental in increasing access to loans, investments, and services for residents in low- and moderate-income communities.

However, the Office of Thrift Supervision (OTS) eliminated the investment and service tests for savings and loans with assets between $250 million and $1 billion. Eliminating these tests means that thrifts will no longer have the incentive to make investments in affordable housing, such as Low-Income Housing Tax Credits, and will no longer be scrutinized by examiners on how many branches and affordable banking services they are making available in low- and moderate-income neighborhoods. CRA also took a further blow from the OTS when that agency ruled to allow thrifts with over $1 billion in assets to choose whether they even want to undergo the investment and service tests, thus giving them the power to pick and choose which community needs they will meet. Yet another final ruling from the FDIC, Federal Reserve Board, and the Office of the Comptroller of the Currency diluted CRA exams for banks with assets between $250 million and $1 billion.

Given the persistence of disparities by income and race as illustrated in this study, it is counterproductive to lessen CRA oversight. If CRA oversight continues to diminish, the level of abusive lending to vulnerable populations is likely to increase even further as traditional lenders reduce the number of branches, bank products, and affordable housing investments in low- and moderate-income communities. Instead, regulators must strengthen CRA exams and hold lenders accountable to communities.

Strengthen CRA by Applying It to Minority Neighborhoods and All Geographical Areas Lenders Serve

In order to increase prime lending for minority borrowers and reduce lending disparities, CRA exams must evaluate the banks' records of lending to minority borrowers and neighborhoods as well as scrutinizing banks' performance in reaching low- and moderate-income borrowers and neighborhoods. If CRA exams covered minority neighborhoods, pricing disparities in these neighborhoods would be reduced. The Federal Reserve Board, in its review of 2004 HMDA data, found that bank lending exhibited fewer disparities in geographical areas covered by their CRA exams than in areas not covered by their exams.[10] CRA's mandate of affirmatively meeting credit needs is currently incomplete as it is now applied only to low- and moderate-income neighborhoods, not minority communities.

CRA must also be strengthened so that depository institutions undergo CRA examinations in all geographical areas in which they make a significant number of loans. Currently, CRA exams assess lending primarily in geographical areas in which banks have their branches. But the overlap between branching and lending is eroding with each passing year as lending via brokers and correspondents continues to increase. NCRC strongly endorses the CRA Modernization Act, HR 865, introduced in the 107th Congress. HR 865 mandates that banks undergo CRA exams in geographical areas in which their market share of loans exceeds one half of one percent in addition to areas in which their branches are located. NCRC will be working with members of Congress to update and reintroduce CRA Modernization legislation.

Short of statutory changes to CRA, NCRC believes that the regulatory agencies have the authority to extend CRA examinations and scrutiny to geographical areas beyond narrow "assessment" areas in which branches are located. Currently, the federal banking agencies will consider lending activity beyond assessment areas if the activity will enhance CRA performance. Likewise, the CRA rating must be downgraded if the lending performance in reaching low- and moderate-income borrowers is worse outside than inside the assessment areas.

CRA Exams Must Scrutinize Subprime Lending More Rigorously

Currently, CRA exams are not adequately assessing the CRA performance of subprime lenders. For example, the CRA exam of the subprime lender, Superior Bank, FSB, called its lending innovative and flexible before that thrift's spectacular collapse.[11] Previous NCRC comment letters to the regulators have documented cursory fair lending reviews

[10] Avery and Canner, op. cit.

[11] Office of Thrift Supervision Central Region's CRA Evaluation of Superior Bank, FSB, Docket #: 08566, September 1999. Available via http://www.ots.treas.gov, go to the CRA search engine and select "inactive" for the status of the institution being searched.

for the great majority of banks and thrifts involved in subprime lending.[12] If CRA exams continue to mechanistically consider subprime lending, subprime lenders will earn good ratings since they usually offer a larger portion of their loans to low- and moderate-income borrowers and communities than prime lenders.

At this point, the federal regulatory agencies have amended the CRA regulation to penalize banks if their lending violates federal anti-predatory law. NCRC has not seen rigorous action to implement this aspect of the CRA regulation. Fair lending reviews that accompany CRA exams do not usually scrutinize subprime lending for compliance with anti-predatory law, for possible pricing discrimination, or whether abusive loans are exceeding borrower ability to repay. NCRC recommends that all CRA exams of subprime lenders must be accompanied by a comprehensive fair lending and anti-predatory lending audit. In addition, CRA exams must ensure that prime lenders are not financing predatory lending through their secondary market activity or servicing abusive loans.

GSEs Must Abide by Anti-Predatory Safeguards

The Government-Sponsored Enterprises (GSEs), including Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, purchase more than half of the home loans made on an annual basis in this country. It is vitally important, therefore, that the GSEs have adopted adequate protections against purchasing predatory loans. Fannie Mae and Freddie Mac have voluntarily adopted significant protections such as purchasing no loans with fees exceeding five percent of the loan amount, no loans involving price discrimination or steering, no loans with prepayment penalties beyond three years, and no loans with mandatory arbitration. The Department of Housing and Urban Development (HUD) has ruled that Fannie Mae and Freddie Mac will not receive credit towards their Affordable Housing Goals for any loans that contain certain abusive features.

HUD's ruling is an important first step, but it needs to be enhanced. HUD's ruling, for example, does not include disqualification from goals consideration of loans with mandatory arbitration. The Federal Housing Finance Board, as the regulator for the Federal Home Loan Banks, has not formally applied protections against abusive loans to the Home Loan Banks. Congress has an opportunity to further bolster the anti-predatory protections applied to GSE loan purchasing activity as Congress considers GSE regulatory reform.

[12] NCRC comment letter to federal banking agencies on joint CRA proposal, April 2, 2004. Available via: http://www.ncrc.org.

Lender Affiliates Used in Report

This list includes many, but not all the affiliates of lenders analyzed in this report.

- **Ameriquest:**

  Argent Mortgage
  AMC Mortgage Services, Inc.
  Ameriquest Mortgage Company
  Town & Country Credit Corp.

- **Bank of America:**

  Bank of America
  MBNA America
  Nexstar Financial

- **BB&T:**

  BB&T NC
  BB&T SC
  BB&T VA
  Laureate Capital Public
  Lendmark Financial Public
  Lendmark Mortgage Public
  Liberty Mortgage Public

- **Chase:**

  JP Morgan Chase Bank, NA
  Chase USA, NA

- **Citigroup:**

  Citibank, FSB
  Citibank, N.A.
  Citicorp Trust Bank, fsb
  Citibank (West), FSB
  California Commerce Bank
  Citibank Texas, N.A.
  CitiFinancial Inc (a Hawaii corporation)
  CitiFinancial, Inc. (an Ohio corporation)
  CitiFinancial Services, Inc. (a Pennsylvania corporation)
  CitiFinancial Services, Inc. (a Minnesota corporation)
  CitiFinancial, Inc. (a West Virginia corporation)
  CitiFinancial, Inc. (a Tennessee corporation)
  CitiFinancial Services, Inc. (an Ohio corporation)
  CitiFinancial Services, Inc. (a Delaware corporation)
  CitiFinancial Services, Inc. (a Missouri corporation)

CitiFinancial of Virginia, Inc. (a Virginia corporation)
CitiFinancial Services, Inc. (a Georgia corporation)
CitiFinancial, Inc. (a South Carolina corporation)
CitiFinancial, Inc. (a Maryland corporation)
CitiFinancial Services, Inc. (an Oklahoma corporation)
CitiFinancial Services, Inc. (a Kentucky corporation)
CitiFinancial, Inc. (an Iowa corporation)
CitiFinancial Services, Inc. (a California corporation)
CitiFinancial Company (a Delaware corporation)
CitiFinancial Corporation (a Colorado corporation)
CitiFinancial, Inc. (a Texas corporation)
CitiFinancial Services, Inc. (a Massachusetts corporation)
CitiFinancial Mortgage Corp.
Associates Housing Finance
CitiFinancial Corporation, LLC (an Iowa corporation)
CitiFinancial Services of Puerto Rico
Associates International Holding Corp.
CitiMortgage, Inc.
CMFC, Inc. / PRCM

- **Countrywide:**

Countrywide Bank
Countrywide Real Estate Finance
Countrywide LLC

- **HSBC:**

HSBC Bank
HFC
HMS (HSBC Mortgage Services)
HSBC Mortgage
Decision One
Beneficial

- **KeyBank:** *No affiliates*

- **National City:**

1st Choice Mortgage, LLC
1st Premier Mortgage, LLC
1st Residential Mortgage, LLC
Acculend Mortgage, LP
Action Home Mortgage, LLC
Affirmative Mortgage, LLC
All American First Mortgage, L
American Best Mortgage, LLC
Americorp First Mortgage, LLC
Amerimax Mortgage, LLC
Ameritrust Home Mortgage, LP

Cape Henry Mortgage, LLC
Capstone Mortgage Funding, LLC
Classic First Mortgage, LLC
Colonial Home Finance, LLC
County CORP Mortgage, LLC
Covenant Mortgage, LLC
Delmarva Mortgage, LLC
Dominion Trust Mortgage, LLC
Enter Mortgage, LLC
Executive Home Mortgage
FCB Mortgage, LLC
First Capital Home Mortgage, L
First Flight Mortgage, LLC
First Independent Mortgage, LL
First Patriot Mortgage, LLC
First Washington Mortgage, LLC
Gateway First Mortgage, LLC
Global Home Mortgage
Heartland Security Mortgage, L
Heritage Home Mortgage, LLC
Home Financing, LLC
Home Mortgage Centre, LLC
Homeland First Mortgage
Homesource Mortgage Services,
Homesync Financial Services, L
Hometown Mortgage, LLC
Intercoastal Mortgage, LLC
Liberty West Mortgage, LLC
Lincoln First Mortgage, LLC
Lower Bucks Mortgage, LLC
Mid Atlantic Mortgage, LLC
Millstone Mortgage, LLC
MNC Mortgage, LP
Mortgage Construction Finance,
Mortgage One, LP
National American Mortgage, LL
NCS First Mortgage, LP
Oak Street Capital, LP
Peninsula Mortgage, LLC
Platinum First Mortgage, LP
Premier Lending Services, LP
Regent Financial Services, LLC
Regional First Mortgage, LLC
Reliable Mortgage Investors, L
REO Mortgage Services, LLC
Summit First Financial, LLC
Supreme Capital Mortgage, LLC
The First Mortgage Group, LLC
Tidewater First Mortgage, LLC
Tower Mortgage, LLC
Town and Country Lending, LLC

Town Square Mortgage, LLC
Valley Mortgage Services, LLC
Virginia First Mortgage, LLC
Virginia Home Mortgage, LL

- **New Century:**

New Century Mortgage
Home 123

- **Option One:**

Option One Mortgage Corp.
H&R Block Mortgage Corp.

- **Suntrust:**

Suntrust Bank
Suntrust Mortgage

- **TD BankNorth:** *No affiliates*

- **U.S. Bank:**

U.S. Bank, NA
U.S. Bank, North Dakota

- **Wachovia:**

Wachovia Bank
Wachovia Mortgage Corporation
Wachovia Bank of Delaware
SouthTrust d/b/a EquiBanc
American Mortgage Network

- **Washington Mutual:**

Washington Mutual Bank
Washington Mutual Bank, FSB
Long Beach Mortgage Company

- **Wells Fargo:**

Wells Fargo Bank, N.A.
Wells Fargo Funding
Wells Fargo Financial California, Inc.
Wells Fargo Financial Texas, Inc.
Wells Fargo Financial System Fl, Inc.
Wells Fargo Financial Illinois, Inc.
Wells Fargo Financial Pennsylvania Inc.

Wells Fargo Financial Arizona, Inc.
Wells Fargo Financial Ohio 1 Inc.
Wells Fargo Financial Washington 1, Inc.
Wells Fargo Financial America, Inc.
Wells Fargo Financial Minnesota, Inc.
Wells Fargo Financial Nevada 2, Inc.
Wells Fargo Financial Alabama, Inc.
Wells Fargo Financial Credit Services NY, Inc.
Wells Fargo Financial, Wisconsin, Inc.
Wells Fargo Financial Missouri, Inc.
Wells Fargo Financial Oregon, Inc.
Wells Fargo Financial Maryland, Inc.
Wells Fargo Financial Colorado, Inc.
Wells Fargo Financial Georgia, Inc.
Wells Fargo Financial Indiana, Inc.
Wells Fargo Financial Tennessee 1, LLC
Wells Fargo Financial North Carolina 1, Inc.
Wells Fargo Financial New Mexico Inc.
Wells Fargo Financial System Virginia, Inc.
Wells Fargo Financial Louisiana, Inc.
Wells Fargo Financial New Jersey Inc.
Wells Fargo Financial Iowa 3, Inc.
Prosperity Mortgage Company
Wells Fargo Financial Utah, Inc.
Wells Fargo Financial South Carolina, Inc.
Wells Fargo Financial Massachusetts, Inc.
Wells Fargo Financial Nebraska, Inc.
Wells Fargo Financial Alaska, Inc.
Wells Fargo Financial Mississippi 2, Inc.
Wells Fargo Financial Kentucky, Inc.
Wells Fargo Financial Idaho, Inc.
Wells Fargo Financial Oklahoma, Inc.
Wells Fargo Financial West Virginia, Inc.
Wells Fargo Financial Kansas, Inc.
Wells Fargo Home Mortg. Hawaii
Wells Fargo Financial Montana, Inc.
Wells Fargo Financial Hawaii, Inc.
Homeservices Lending, LLC
Wells Fargo Financial Tennessee, Inc.
Wells Fargo Financial South Dakota, Inc.
Wells Fargo Financial North Dakota, Inc.
Wells Fargo Financial Wyoming, Inc.
Wells Fargo Financial Maine, Inc.
Wells Fargo Financial Delaware, Inc.
Wells Fargo Financial Rhode Island, Inc.
Academy Financial Services LLC
Wells Fargo Financial New Hampshire 1 Inc.
UBS Mortgage LLC
Legacy Mortgage
Linear Financial, LP
Mercantile Mortgage, LLC

Real Living Mortgage, LLC
Edward Jones Mortgage, LLC
BW Mortgage, LLC
Morrison Financial Services
Westfield Home Mortgage, LLC
Ashton Woods Mortgage, LLC
Advance Mortgage
Private Mortgage Advisors, LLC
Meridian Mome Mortgage, LP
PCM Mortgage, LLC
River City Group, LLC
Hewitt Mortgage Services, LLC
John Laing Mortgage, LP
Colorado Mortgage Alliance LLC
First Foundation Mortgage, LLC
Residential Comt'y Mortgage Co
MSC Mortgage, LLC
Security First Finl Group, LLC
Santa Fe Mortgage, LLC
American Priority Mortgage, LLC
Home Loan Express, LLC
Priority Mortgage, LLC
Related Financial, LLC
Choice Home Financing, LLC
DH Financial, LLC
Windward Home Mortgage, LLC
Mortgage One
Secursource Mortgage, LLC
Benefit Mortgage, LLC
Resortquest Mortgage, LLC
Mortgages On-Site, LLC
Properties Mortgage, LLC
Playground Financial Services
Southern Ohio Mortgage, LLC
Trinity Mortgage Affiliates
Pinnacle Mortgage of Nevada
Personal Mortgage Group, LLC
Trademark Mortgage, LLC
Great East Mortgage, LLC
First Mortgage Consultants LLC
WF/TW Mortgage Venture, LLC
Southeast Home Mortgage, LLC
Max Mortgage, LLC
Central Federal Mortgage Co
Hallmark Mortgage Group, LLC
Greenridge Mortgage Services
Horizon Mortgage, LLC
Fulton Homes Mortgage, LLC
Roddel Mortgage Company, LP
American Southern Mortgage Srv
New England Home Loans, LLC

Professl Finl Servs of Arizona
Builders Mortgage Company, LLC
Smart Mortgage, LLC
Traditions Mortgage, LLC
Stock Financial Services, LLC
Real Estate Financial
Avenue Financial Services, LLC
Capital Pacific Home Loans, LP
Colorado Professionals Mortgage
Mortgages Unlimited, LLC
Express Fin'l & Mortgage Servc
Certified Home Loans, LLC
MJC Mortgage Company, LLC
Realty Home Mortgage, LLC
NDC Financial Services, LLC
Discovery Home Loans, LLC
Touchstone Home Mortgage, LLC
Mortgage 100, LLC
Summit National Mortgage, LLC
Ennis Home Mortgage, LP 12/05
Hendricks Mortgage, LLC
Family Home Mortgage, LLC
Vista Mortgage, LLC
JTS Financial, LLC
1st Capital Mortgage, LLC
IMS Mortgage Company
Foundation Mortgage Services
Northwest Home Finance, LLC
PNC Mortgage, LLC
Smith Family Mortgage, LLC
First Rate Home Mortgage, LLC
Bellwether Mortgage, LLC
Empire Homes Financial Servs
First Associates Mortgage, LLC
Ohio Executive Mortgage Co
Realtec Financial Services LLC
Keller Mortgage, LLC
Gold Coast Mortgage
Steinbeck Advantage Mortgage
1st Fin'l Services of Colorado
Guanantee Pacific Mortgage LLC
Next Home Mortgage
Gold Coast Home Mortgage
Real Estate Lenders
MC of America, LLC
Sunsouth Mortgage, LLC
Paramount Mortgage of Polk County, LLC
Washington Mortgage, LLC
Premier Home Mortgage
Financial Resources Mortgage
Builders Capital Mortgage, LLC

Belgravia Mortgage Group, LLC
Silver State Home Mortgage LL
Servicing Mortgage Company LL
Central Bucks Mortgage, LLC
Hearthside Funding, LP
Waterways Home Mortgage, LLC
Alpha Home Loans, LLC
Riverside Home Loans, LLC
Mutual Service Mortgage, LLC
Precedent Mortgage, LLC
Leader Mortgage, LLC
Homeland Mortgage, LLC
Tricom Mortgage, LLC
Genesis Mortgage, LLC
Stoneridge Mortgage, LLC
Parkway Mortgage Financial Ctr
Triple Diamond Mortgage & Finl
EDI Mortgage, LLC
APM Mortgage, LLC
Pageantry Mortgage, LLC
Sundance Mortgage, LLC
United Michigan Mortgage, LLC
Amber Mortgage, LLC
Capstone Home Mortgage, LLC
Russ Lyon Mortgage, LLC
Hometown Mortgage, LLC
Mortgage Dymanics, LLC
BHS Home Loans, LLC
Choice Mortgage Servicing, LLC
National Condo Lending, LLC
South County Mortgage
Advantage Mortgage Partners, LLC
Provident Mortgage Company LLC
Advantage Home Mortgage, LLC
Homebuilders Choice Mortgage
New West Mortgage Services, LLC
Alliance Home Mortgage, LLC
Peak Home Mortgage, LLC
Hubble Home Loans, LLC
Marben Mortgage, LLC
RWF Mortgage, LLC
United Mortgage Group
KD Mortgage, LLC
Master Home Mortgage, LLC
Pacific Coast Home Mortgage, LLC
Forecast Home Mortgage, LLC
Michigan Home Mortgage, LLC

Appendix – Tables 1 through 13

Table 1 - Conventional Single Family Loans

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	149,452	6,966	33,803	235,985	7,715	726,960	241,924	1,402,805	844,457	523,412	34,932	4	1,402,805	222,885	346,246	818,339	1,387,470
	Row %	10.70%	0.50%	2.40%	16.80%	0.50%	51.80%	17.20%		60.20%	37.30%	2.50%	0.00%		16.10%	25.00%	59.00%	
	Col %	28.30%	35.00%	14.50%	54.50%	31.20%	23.30%	40.70%		26.20%	34.40%	16.20%	0.10%		44.60%	39.00%	24.40%	
	Table %	3.00%	0.10%	0.70%	4.80%	0.20%	14.70%	4.90%		17.00%	10.60%	0.70%	0.00%		4.70%	7.30%	17.30%	
	Mean	4.80	4.68	4.47	4.81	4.54	4.65	4.59		4.65	4.71	4.69	3.97		4.91	4.76	4.60	
	Median	4.7	4.54	4.4	4.72	4.44	4.53	4.52		4.55	4.62	4.51	3.53		4.8	4.66	4.51	
Market Rate	Count	378,686	12,910	199,421	196,846	16,992	2,397,472	352,131	3,554,458	2,374,320	996,060	180,383	3,695	3,554,458	274,537	542,473	2,534,931	3,351,941
	Row %	10.70%	0.40%	5.60%	5.50%	0.50%	67.40%	9.90%		66.80%	28.00%	5.10%	0.10%		8.20%	16.20%	75.60%	
	Col %	71.70%	65.00%	85.50%	45.50%	68.80%	76.70%	59.30%		73.80%	65.60%	83.80%	99.90%		55.20%	61.00%	75.80%	
	Table %	7.60%	0.30%	4.00%	4.00%	0.30%	48.40%	7.10%		47.90%	20.10%	3.60%	0.10%		5.80%	11.40%	53.50%	

Table 2 - Government Insured Single Family Loans

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	59	7	7	173	1	442	101	790	462	301	27		790	226	246	289	761
	Row %	7.50%	0.90%	0.90%	21.90%	0.10%	55.90%	12.80%		58.50%	38.10%	3.40%			29.70%	32.30%	38.00%	
	Col %	0.50%	0.70%	0.40%	0.70%	0.20%	0.40%	0.60%		0.40%	0.60%	0.50%			0.70%	0.50%	0.50%	
	Table %	0.00%	0.00%	0.00%	0.10%	0.00%	0.30%	0.10%		0.30%	0.20%	0.00%			0.20%	0.20%	0.20%	
	Mean	3.49	4.12	3.35	3.38	3.96	3.62	3.78		3.42	3.82	3.58			3.53	3.48	3.65	
	Median	3.19	3.5	3.31	3.29	3.96	3.31	3.29		3.28	3.35	3.34			3.26	3.27	3.33	
Market Rate	Count	10,855	1,014	1,893	25,687	570	115,917	17,352	173,288	118,489	49,656	5,140	3	173,288	33,682	50,504	59,149	143,335
	Row %	6.30%	0.60%	1.10%	14.80%	0.30%	66.90%	10.00%		68.40%	28.70%	3.00%	0.00%		23.50%	35.20%	41.30%	
	Col %	99.50%	99.30%	99.60%	99.30%	99.80%	99.60%	99.40%		99.60%	99.40%	99.50%	100.00%		99.30%	99.50%	99.50%	
	Table %	6.20%	0.60%	1.10%	14.80%	0.30%	66.60%	10.00%		68.10%	28.50%	3.00%	0.00%		23.40%	35.00%	41.00%	

Table 3 - Conventional & Government Single Family Loans

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	149,511	6,973	33,810	236,158	7,716	727,402	242,025	1,403,595	844,919	523,713	34,959	4	1,403,595	223,111	346,492	818,628	1,388,231
	Row %	10.70%	0.50%	2.40%	16.80%	0.50%	51.80%	17.20%		60.20%	37.30%	2.50%	0.00%		16.10%	25.00%	59.00%	
	Col %	27.70%	33.40%	14.40%	51.50%	30.50%	22.40%	39.60%		25.30%	33.40%	15.90%	0.10%		42.00%	36.90%	24.00%	
	Table %	2.90%	0.10%	0.70%	4.60%	0.20%	14.20%	4.70%		16.50%	10.20%	0.70%	0.00%		4.60%	7.10%	16.80%	
	Mean	4.80	4.68	4.47	4.81	4.54	4.65	4.59		4.65	4.71	4.69	3.97		4.91	4.76	4.60	
	Median	4.7	4.54	4.4	4.71	4.44	4.53	4.52		4.55	4.62	4.51	3.53		4.8	4.66	4.5	
Market Rate	Count	389,541	13,924	201,314	222,533	17,562	2,513,389	369,483	3,727,746	2,492,809	1,045,716	185,523	3,698	3,727,746	308,219	592,977	2,594,080	3,495,276
	Row %	10.40%	0.40%	5.40%	6.00%	0.50%	67.40%	9.90%		66.90%	28.10%	5.00%	0.10%		8.80%	17.00%	74.20%	
	Col %	72.30%	66.60%	85.60%	48.50%	69.50%	77.60%	60.40%		74.70%	66.60%	84.10%	99.90%		58.00%	63.10%	76.00%	
	Table %	7.60%	0.30%	3.90%	4.30%	0.30%	49.00%	7.20%		48.60%	20.40%	3.60%	0.10%		6.30%	12.10%	53.10%	

Table 4 - Conventional Refinance Single Family Loans

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	108,067	4,183	12,438	129,159	4,113	429,310	107,902	795,172	468,952	303,247	22,970	3	795,172	137,194	208,778	445,500	791,472
	Row %	13.60%	0.50%	1.60%	16.20%	0.50%	54.00%	13.60%		59.00%	38.10%	2.90%	0.00%		17.30%	26.40%	56.30%	
	Col %	34.30%	36.50%	14.60%	52.20%	31.30%	26.00%	37.30%		28.10%	36.90%	18.60%	0.30%		46.80%	41.00%	26.80%	
	Table %	4.10%	0.20%	0.50%	4.90%	0.20%	16.40%	4.10%		17.90%	11.60%	0.90%	0.00%		5.60%	8.50%	18.10%	
	Mean	4.87	4.68	4.49	4.80	4.59	4.66	4.64		4.68	4.74	4.73	4.28		4.89	4.76	4.63	
	Median	4.78	4.54	4.4	4.7	4.48	4.55	4.56		4.57	4.65	4.56	3.54		4.79	4.66	4.53	
Market Rate	Count	207,291	7,272	72,992	118,213	9,029	1,222,473	181,762	1,819,032	1,198,215	519,211	100,551	1,055	1,819,032	156,012	299,983	1,214,571	1,670,566
	Row %	11.40%	0.40%	4.00%	6.50%	0.50%	67.20%	10.00%		65.90%	28.50%	5.50%	0.10%		9.30%	18.00%	72.70%	
	Col %	65.70%	63.50%	85.40%	47.80%	68.70%	74.00%	62.70%		71.90%	63.10%	81.40%	99.70%		53.20%	59.00%	73.20%	
	Table %	7.90%	0.30%	2.80%	4.50%	0.30%	46.80%	7.00%		45.80%	19.90%	3.80%	0.00%		6.30%	12.20%	49.30%	

Table 5 - Conventional Home Purchase Loans

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	35,541	1,999	20,167	93,072	3,203	258,516	122,305	534,803	333,183	191,498	10,121	1	534,803	67,540	118,566	337,311	523,417
	Row %	6.60%	0.40%	3.80%	17.40%	0.60%	48.30%	22.90%		62.30%	35.80%	1.90%	0.00%		12.90%	22.70%	64.40%	
	Col %	18.30%	30.00%	14.40%	58.30%	31.40%	19.30%	45.20%		23.60%	30.80%	12.00%	0.00%		39.90%	35.50%	21.70%	
	Table %	1.70%	0.10%	1.00%	4.40%	0.20%	12.20%	5.80%		15.70%	9.00%	0.50%	0.00%		3.30%	5.80%	16.40%	
	Mean	4.63	4.67	4.46	4.82	4.47	4.62	4.53		4.61	4.66	4.61	3.05		4.91	4.76	4.56	
	Median	4.5	4.57	4.41	4.73	4.4	4.52	4.48		4.52	4.58	4.45	3.05		4.81	4.67	4.49	
Market Rate	Count	158,335	4,671	119,881	66,663	6,990	1,078,341	148,345	1,583,226	1,076,898	429,980	73,881	2,467	1,583,226	101,635	215,394	1,216,325	1,533,354
	Row %	10.00%	0.30%	7.60%	4.20%	0.40%	68.10%	9.40%		68.00%	27.20%	4.70%	0.20%		6.60%	14.00%	79.30%	
	Col %	81.70%	70.00%	85.60%	41.70%	68.60%	80.70%	54.80%		76.40%	69.20%	88.00%	100.00%		60.10%	64.50%	78.30%	
	Table %	7.50%	0.20%	5.70%	3.10%	0.30%	50.90%	7.00%		50.80%	20.30%	3.50%	0.10%		4.90%	10.50%	59.10%	

Table 6 - Conventional Home Improvement Loans

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	5,844	784	1,198	13,754	399	39,134	11,717	72,830	42,322	28,667	1,841		72,830	18,151	18,902	35,528	72,581
	Row %	8.00%	1.10%	1.60%	18.90%	0.50%	53.70%	16.10%		58.10%	39.40%	2.50%			25.00%	26.00%	48.90%	
	Col %	30.90%	44.80%	15.50%	53.50%	29.10%	28.80%	34.70%		29.90%	38.00%	23.60%			51.80%	41.10%	25.50%	
	Table %	2.60%	0.30%	0.50%	6.10%	0.20%	17.40%	5.20%		18.80%	12.70%	0.80%			8.20%	8.60%	16.10%	
	Mean	4.74	4.68	4.49	4.86	4.46	4.68	4.73		4.70	4.76	4.63			5.02	4.76	4.56	
	Median	4.58	4.43	4.35	4.71	4.3	4.51	4.54		4.53	4.59	4.34			4.85	4.59	4.41	
Market Rate	Count	13,060	967	6,548	11,970	973	96,658	22,024	152,200	99,207	46,869	5,951	173	152,200	16,890	27,096	104,035	148,021
	Row %	8.60%	0.60%	4.30%	7.90%	0.60%	63.50%	14.50%		65.20%	30.80%	3.90%	0.10%		11.40%	18.30%	70.30%	
	Col %	69.10%	55.20%	84.50%	46.50%	70.90%	71.20%	65.30%		70.10%	62.00%	76.40%	100.00%		48.20%	58.90%	74.50%	
	Table %	5.80%	0.40%	2.90%	5.30%	0.40%	43.00%	9.80%		44.10%	20.80%	2.60%	0.10%		7.70%	12.30%	47.20%	

Table 7 - Manufactured Housing

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	2,823	228	91	1,685	29	20,743	1,645	27,244	17,059	8,778	1,407		27,244	9,655	8,586	8,990	27,231
	Row %	10.40%	0.80%	0.30%	6.20%	0.10%	76.10%	6.00%		62.60%	32.20%	5.20%			35.50%	31.50%	33.00%	
	Col %	56.70%	57.60%	36.40%	75.80%	42.60%	47.20%	48.40%		46.70%	54.40%	54.90%			55.00%	50.80%	43.50%	
	Table %	5.10%	0.40%	0.20%	3.00%	0.10%	37.50%	3.00%		30.90%	15.90%	2.50%			17.50%	15.60%	16.30%	
	Mean	4.98	4.80	4.32	4.89	5.07	4.71	4.65		4.69	4.79	5.08			4.95	4.75	4.52	
	Median	4.78	4.45	4.14	4.84	4.82	4.48	4.44		4.46	4.56	4.89			4.71	4.52	4.29	
Market Rate	Count	2,153	168	159	537	39	23,207	1,751	28,014	19,433	7,367	1,158	56	28,014	7,896	8,301	11,654	27,851
	Row %	7.70%	0.60%	0.60%	1.90%	0.10%	82.80%	6.30%		69.40%	26.30%	4.10%	0.20%		28.40%	29.80%	41.80%	
	Col %	43.30%	42.40%	63.60%	24.20%	57.40%	52.80%	51.60%		53.30%	45.60%	45.10%	100.00%		45.00%	49.20%	58.50%	
	Table %	3.90%	0.30%	0.30%	1.00%	0.10%	42.00%	3.20%		35.20%	13.30%	2.10%	0.10%		14.30%	15.10%	21.20%	

Table 8 - Subordinate Liens

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	31,587	1,744	12,838	55,117	2,557	197,212	85,700	386,755	236,997	137,118	12,483	157	386,755	31,840	84,840	265,509	382,189
	Row %	8.20%	0.50%	3.30%	14.30%	0.70%	51.00%	22.20%		61.30%	35.50%	3.20%	0.00%		8.30%	22.20%	69.50%	
	Col %	35.10%	43.00%	38.30%	66.40%	53.20%	38.70%	67.30%		44.40%	51.90%	23.40%	35.70%		57.10%	54.70%	42.10%	
	Table %	3.70%	0.20%	1.50%	6.50%	0.30%	23.20%	10.10%		27.80%	16.10%	1.50%	0.00%		3.80%	10.10%	31.60%	
	Mean	6.87	6.96	6.38	6.92	6.54	6.87	6.43		6.72	6.80	7.10	6.86		7.16	6.93	6.64	
	Median	6.61	6.61	6.21	6.72	6.34	6.57	6.28		6.48	6.55	6.81	6.62		10.63	5.43	5.43	
Market Rate	Count	58,289	2,311	20,690	27,913	2,252	311,956	41,595	465,006	296,608	127,284	40,831	283	465,006	23,943	70,132	364,914	458,989
	Row %	12.50%	0.50%	4.40%	6.00%	0.50%	67.10%	8.90%		63.80%	27.40%	8.80%	0.10%		5.20%	15.30%	79.50%	
	Col %	64.90%	57.00%	61.70%	33.60%	46.80%	61.30%	32.70%		55.60%	48.10%	76.60%	64.30%		42.90%	45.30%	57.90%	
	Table %	6.80%	0.30%	2.40%	3.30%	0.30%	36.80%	4.90%		34.80%	14.90%	4.80%	0.00%		2.80%	8.30%	43.40%	

Table 9 - Home Purchase Only – Preapproval Requested

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	1,183	55	319	2,424	56	6,653	2,501	13,191	8,224	4,635	332		13,191	2,182	3,723	7,108	13,013
	Row %	9.00%	0.40%	2.40%	18.40%	0.40%	50.40%	19.00%		62.30%	35.10%	2.50%			16.80%	28.60%	54.60%	
	Col %	11.70%	13.50%	5.30%	33.90%	12.70%	10.90%	24.80%		13.30%	16.70%	5.60%			22.60%	21.60%	10.60%	
	Table %	1.20%	0.10%	0.30%	2.50%	0.10%	7.00%	2.60%		8.60%	4.90%	0.30%			2.30%	4.00%	7.50%	
	Mean	4.92	5.31	4.99	5.54	4.95	5.23	5.10		5.20	5.28	5.24			5.48	5.33	5.13	
	Median	4.87	5.18	5.01	5.49	5.04	5.19	5.1		5.15	5.25	5.26			5.49	5.29	5.11	
Market Rate	Count	8,924	353	5,741	4,732	386	54,577	7,599	82,312	53,580	23,129	5,594	9	82,312	7,455	13,496	60,203	81,154
	Row %	10.80%	0.40%	7.00%	5.70%	0.50%	66.30%	9.20%		65.10%	28.10%	6.80%	0.00%		9.20%	16.60%	74.20%	
	Col %	88.30%	86.50%	94.70%	66.10%	87.30%	89.10%	75.20%		86.70%	83.30%	94.40%	100.00%		77.40%	78.40%	89.40%	
	Table %	9.30%	0.40%	6.00%	5.00%	0.40%	57.10%	8.00%		56.10%	24.20%	5.90%	0.00%		7.90%	14.30%	63.90%	

Table 10 - Home Purchase Only -- Preapproval Not Requested

		Race and Ethnicity								Gender					Median Income			
		Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total	Male	Female	Information not provided by applicant	Not applicable	Total	Low & Moderate	Middle	High	Total
High-Cost	Count	7,907	352	2,109	12,977	341	52,054	12,763	88,503	55,732	30,223	2,548		88,503	15,179	22,463	45,939	83,581
	Row %	8.90%	0.40%	2.40%	14.70%	0.40%	58.80%	14.40%		63.00%	34.10%	2.90%			18.20%	26.90%	55.00%	
	Col %	9.30%	12.30%	3.40%	26.80%	8.90%	7.90%	14.60%		8.70%	11.20%	6.90%			19.40%	14.40%	6.70%	
	Table %	0.80%	0.00%	0.20%	1.40%	0.00%	5.50%	1.30%		5.90%	3.20%	0.30%			1.60%	2.40%	5.00%	
	Mean	4.52	4.57	4.27	4.71	4.40	4.51	4.33		4.50	4.52	4.57			4.73	4.64	4.46	
	Median	4.27	4.37	4.06	4.53	4.17	4.27	4.07		4.26	4.29	4.31			4.48	4.45	4.26	
Market Rate	Count	77,155	2,503	59,826	35,423	3,477	605,049	74,465	857,898	584,921	238,495	34,356	126	857,898	63,033	133,984	640,337	837,354
	Row %	9.00%	0.30%	7.00%	4.10%	0.40%	70.50%	8.70%		68.20%	27.80%	4.00%	0.00%		7.50%	16.00%	76.50%	
	Col %	90.70%	87.70%	96.60%	73.20%	91.10%	92.10%	85.40%		91.30%	88.80%	93.10%	100.00%		80.60%	85.60%	93.30%	
	Table %	8.20%	0.30%	6.30%	3.70%	0.40%	63.90%	7.90%		61.80%	25.20%	3.60%	0.00%		6.80%	14.50%	69.50%	

Table 11 - HOEPA Loans by Race

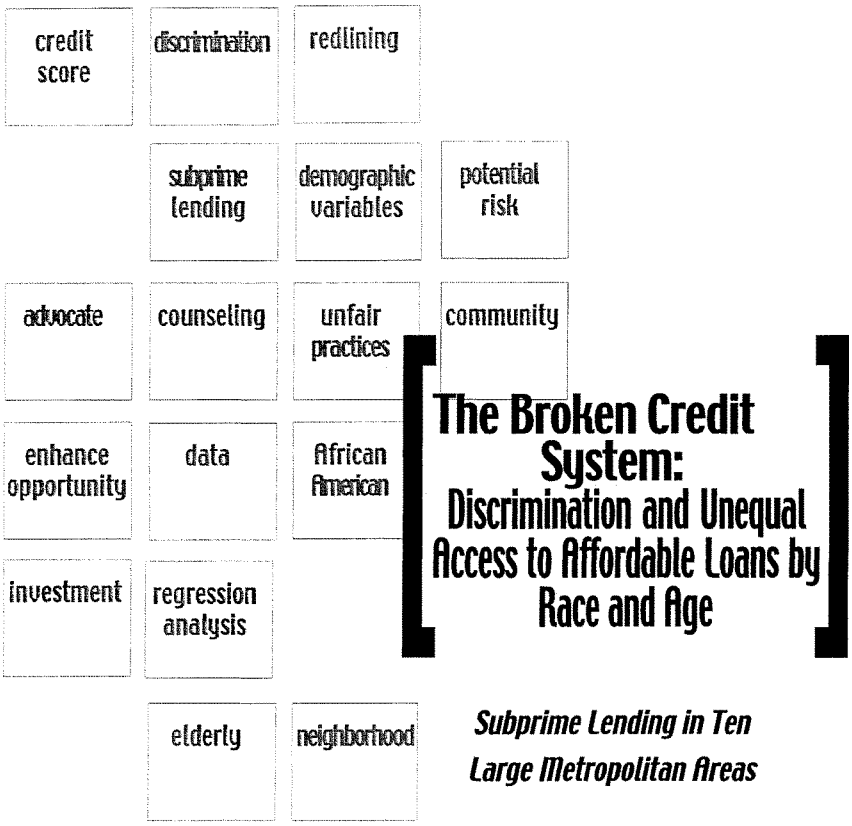
			Race and Ethnicity							
			Not applicable or information not provided by applicant	American Indian or Alaska Native (non-Hispanic)	Asian (non-Hispanic)	Black or African American (Hispanic & non-Hispanic)	Native Hawaiian or Other Pacific Islander (non-Hispanic)	White (non-Hispanic)	Hispanic (non-Black)	Total
High-Cost	HOEPA loan	Count	707	62	58	874	27	3,907	463	6,098
		Row %	11.59%	1.02%	0.95%	14.33%	0.44%	64.07%	7.59%	
		Mean	11.14	13.01	12.46	12.37	12.87	12.45	11.63	
		Median	10.89	13.42	12.49	12.36	13.97	12.52	11.34	
	Non-HOEPA loan	Count	130,353	5,867	16,185	160,705	5,307	566,530	133,989	1,018,936
		Row %	12.79%	0.58%	1.59%	15.77%	0.52%	55.60%	13.15%	
		Mean	5.12	5.02	4.82	5.07	4.89	5.04	4.88	
		Median	4.98	4.75	4.64	4.87	4.71	4.8	4.7	
Market-Rate	HOEPA loan	Count	2	0	0	2	0	13	2	19
		Row %	10.53%	0.00%	0.00%	10.53%	0.00%	68.42%	10.53%	
	Non-HOEPA loan	Count	262,349	10,283	87,940	153,950	11,239	1,526,978	227,459	2,280,198
		Row %	11.51%	0.45%	3.86%	6.75%	0.49%	66.97%	9.98%	

Table 12 - HOEPA Loans by Gender

			Gender				
			Male	Female	Information not provided by applicant	Not applicable	Total
High-Cost	HOEPA loan	Count	3,272	2,237	589	0	6,098
		Row %	53.66%	36.68%	9.66%	0.00%	
		Mean	12.4	12.34	10.92	.	
		Median	12.41	12.4	10.68	.	
	Non-HOEPA loan	Count	602,476	383,504	32,797	159	1,018,936
		Row %	59.13%	37.64%	3.22%	0.02%	
		Mean	5.01	5.04	5.29	6.82	
		Median	4.79	4.84	5.05	6.61	
Market-Rate	HOEPA loan	Count	12	5	2	0	19
		Row %	63.16%	26.32%	10.53%	0.00%	
	Non-HOEPA loan	Count	1,490,981	650,131	137,587	1,499	2,280,198
		Row %	65.39%	28.51%	6.03%	0.07%	

Table 13 - HOEPA Loans by Income of Borrower

			Median Income			
			Low & Moderate	Middle	High	Total
High-Cost	HOEPA loan	Count	1,163	1,894	3,035	6,092
		Row %	19.09%	31.09%	49.82%	
		Mean	11.52	12.39	12.42	
		Median	10.53	12.52	12.29	
	Non-HOEPA loan	Count	174,209	265,447	574,862	1,014,518
		Row %	17.17%	26.16%	56.66%	
		Mean	5.12	5.08	4.99	
		Median	4.93	4.86	4.77	
Market-Rate	HOEPA loan	Count	3	3	10	16
		Row %	18.75%	18.75%	62.50%	
	Non-HOEPA loan	Count	191,890	371,566	1,530,896	2,094,352
		Row %	9.16%	17.74%	73.10%	



The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age

Subprime Lending in Ten Large Metropolitan Areas

The National Community Reinvestment Coalition

The National Community Reinvestment Coalition (NCRC) is the nation's trade association for economic justice whose members consist of local community based organizations. Since its inception in 1990, NCRC has spearheaded the economic justice movement. NCRC's mission is to build wealth in traditionally underserved communities and bring low- and moderate-income populations across the country into the financial mainstream. NCRC members have constituents in every state in America, in both rural and urban areas.

The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication and serve as a resource to all of us in the public and private sector who are committed to responsible lending. For more information, please contact:

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A special word of thanks to Mark Treskon, Milena Kornil, Josh Silver, and Dan Immergluck. As a former NCRC Research Analyst, Mark started this report and conducted the initial analysis that informed the methodology. Josh Silver and Milena Kornil teamed up to complete the data analysis and write the report narrative. Without their invaluable contributions, this report would not be as timely or comprehensive. Dr. Dan Immergluck, a professor at Grand Valley State University, provided expert peer review, consulting, and quick and thorough proofreading. His skilled assistance augmented the statistical rigor and meaning of the report.

NCRC

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Executive Summary

The credit system is broken and discrimination is widespread in America. NCRC finds that African-American and predominantly elderly communities receive a considerably higher level of high cost subprime loans than is justified based on the credit risk of neighborhood residents. President Bush has declared an Administration's goal of 5.5 million new minority homeowners by the end of the decade. The widespread evidence of price discrimination, however, threatens the possibility of creating sustainable and affordable homeownership opportunities for residents of traditionally underserved neighborhoods.

The widespread evidence of price discrimination threatens the possibility of creating sustainable and affordable homeownership opportunities . . .

A subprime loan has an interest rate higher than prevailing and competitive rates in order to compensate for the added risk of lending to a borrower with impaired credit. NCRC defines a predatory loan as an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers. Predatory loans are a subset of subprime loans. A predatory loan has one or more of the following features: 1) charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections, 2) contains abusive terms and conditions that trap borrowers and lead to increased indebtedness, 3) does not take into account the borrower's ability to repay the loan, and 4) violates fair lending laws by targeting women, minorities and communities of color. Using the best available industry data on credit worthiness, NCRC uncovered a substantial amount of predatory lending involving rampant pricing discrimination and the targeting of minority and elderly communities.

Sadly, it is still the case in America that the lending marketplace is a dual

marketplace, segmented by race and age. If a consumer lives in a predominantly minority community, he or she is much more likely to receive a high cost and discriminatory loan than a similarly qualified borrower in a white community. At the same time, the elderly, who have often built up substantial amounts of equity and wealth in their homes, are much more likely to receive a high cost refinance loan than a similarly qualified younger borrower. The disproportionate amount of subprime refinance lending in predominantly elderly neighborhoods imperils the stability of long-term wealth in communities and the possibilities of the elderly passing their wealth to the next generation.

Lending discrimination in the form of steering high cost loans to minorities and elderly borrowers qualified for market rate loans results in equity stripping and has contributed to inequalities in wealth. According to the Federal Reserve Survey of Consumer Finances, the median value of financial assets was $38,500 for whites, but only $7,200 for minorities in 2001. Whites have more than five times the dollar amount of financial assets than minorities. Likewise the median home value for whites was $130,000 and only $92,000 for minorities in 2001.[1]

This report confirms Americans' perceptions of bias in lending. In the winter of 2002, NCRC hired Republican pollster Frank Luntz and Democratic pollster Jennifer Laszlo Mizrahi to conduct a nationally representative poll of Americans' views of lending institutions. In the poll, fully 76 percent of Americans believed that steering creditworthy minorities and women to costly loan products was a significant problem. About 47

[1] Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, Federal Reserve Bulletin, January 2003.

percent of the survey respondents believed that a white man would be more likely than an African-American man with the same credit history to be approved for a loan. Only 10 percent of the respondents believed that the African-American would be more likely to be approved for a loan. Among African-American survey respondents, 74 percent thought the white man would be approved, and only 3.6 percent thought that a similarly qualified African-American would be approved over the white man. Unfortunately, this report verifies that these perceptions of discriminatory treatment are reality in too many instances.[2]

The single most utilized defense of lenders and their trade associations concerning bias is that credit scoring systems allow lenders to be colorblind in their loan decisions. This study, the largest and among the first of its kind, debunks that argument and clearly makes the case that African-American and elderly neighborhoods, regardless of the creditworthiness of their residents, receive a disproportionate amount of high cost subprime loans.

NCRC selected ten large metropolitan areas for the analysis: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington, D.C. As expected, the amount of subprime loans increased as the amount of neighborhood residents in higher credit risk categories increased. After controlling for risk and housing market conditions, however, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending. In particular:

[2] A Laszlo/Luntz Poll, conducted January 21 to February 13, 2002. Overall poll of 1,258 adults, margin of error 3.3%. Available via NCRC.

- The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas.

- The percent of African-Americans in a census tract had the strongest impact on subprime refinance lending in Houston, Milwaukee, and Detroit. Even after holding income, creditworthiness, and housing market factors constant, going from an all white to an all African-American neighborhood (100 percent of the census tract residents are African-American) increased the portion of subprime loans by 41 percentage points in Houston. For example, if 10 percent of the refinance loans in the white neighborhood were subprime, then 51 percent of the loans in an African-American neighborhood in Houston would be subprime. The portion of subprime refinance loans increased by 29, 26, and 20 percentage points in Milwaukee, Detroit, and Cleveland, respectively, from an all white to an all African-American neighborhood. Graph 1 provides details of this phenomenon across the metropolitan areas and shows a strong race factor in Atlanta, St. Louis, and Los Angeles as well.

- Solely because the percentage of the African-American population increased, the amount of subprime home purchase lending surged in Cleveland, Milwaukee, and Detroit. From an all white to an all African-American neighborhood in Cleveland, the portion of subprime home purchase loans climbed 24 percentage points. Graph 2 reveals that the portion of subprime purchase loans similarly rose by 18 and 17 percentage points in Milwaukee and Detroit, respectively, in African-American neighborhoods compared to white neighborhoods.

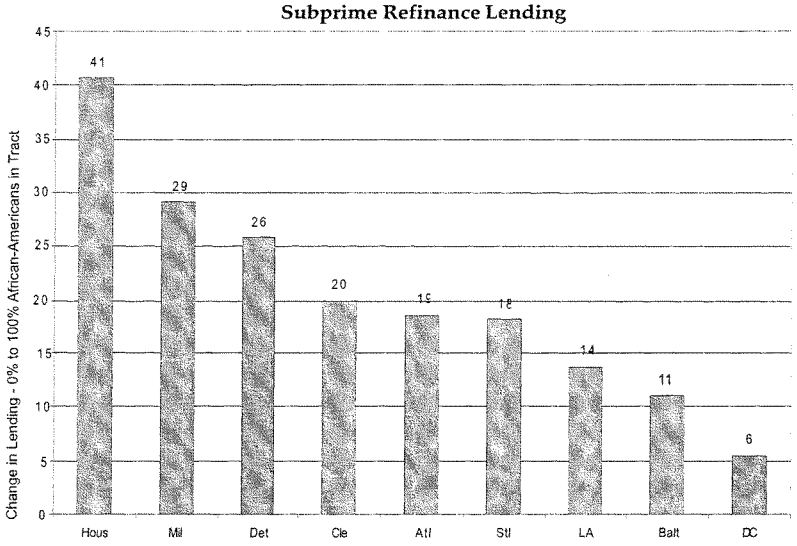
- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.

- Elderly neighborhoods experienced the greatest increases in subprime refinance lending in St. Louis, Atlanta, and Houston. Even after holding income, creditworthiness, and housing market factors constant, the portion of subprime refinance lending would surge 31 percentage points in St. Louis from a neighborhood with none of its residents over 65 to all of its residents over 65. Likewise, the increases were 27 and 25 percentage points in Atlanta and Houston, respectively. Although neighborhoods with such extreme age distributions (none or all residents over 65) are unusual, the regression analysis

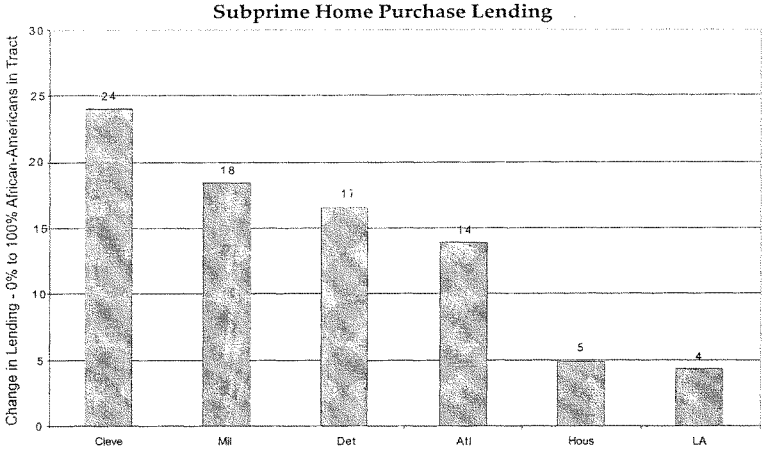
highlights and isolates the impacts of age on the level of subprime lending. Indeed, the level of subprime lending is likely to be considerably higher in neighborhoods with large concentrations of senior citizens.

- The level of subprime lending increased in a statistically significant fashion in the great majority of metropolitan areas as the percentage of neighborhood residents with no credit scores increased. Subprime refinance and home purchase lending climbed in nine and seven metropolitan areas, respectively, as the portion of neighborhood residents without credit scores increased. This is a significant issue for recent immigrants and other unbanked populations, many of whom are creditworthy for loans at prevailing interest rates, but receive high cost loans simply because they lack conventional credit histories.

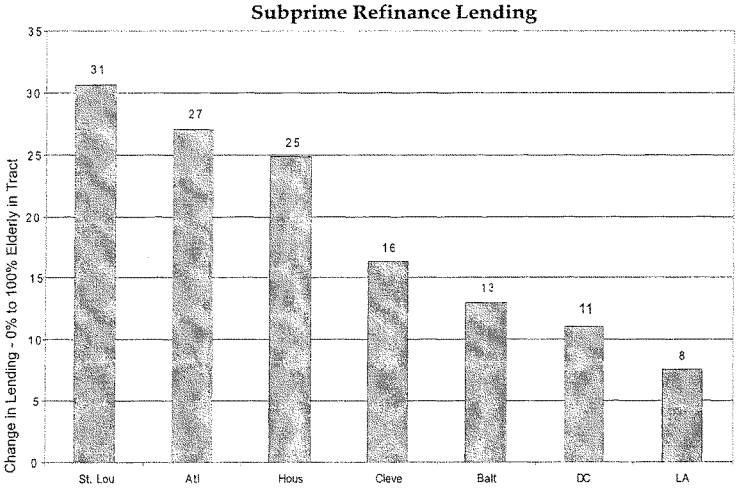
Graph 1: Index of Discrimination Against African-American Neighborhoods: Subprime Refinance Lending



Graph 2: Index of Discrimination Against African-American Neighborhoods: Subprime Home Purchase Lending



Graph 3: Index of Discrimination Against the Elderly: Subprime Refinance Lending



Recommendations

Legislative Recommendations

Reform FCRA to Mandate Complete and Accurate Credit Reports
As Congress renews the Fair Credit Reporting Act (FCRA), it must ensure that credit reports are complete and accurate. Anti-predatory lending bills introduced by members of Congress from both parties (Sarbanes and Ney) require creditors, once every three months, to provide a complete credit report and payment history to credit bureaus regarding all loans they made or serviced. A number of large subprime lenders currently withhold critical information regarding borrower on-time payments.[3] The practice of withholding information victimizes borrowers by trapping them in high cost loans and also victimizes lenders by reducing the overall reliability of the credit reporting system. A bipartisan consensus should be quickly achieved regarding this essential reform, yet the bipartisan House bill, HR 2622, does not contain this requirement. The FCRA bill proceeding in the Senate also does not require frequent reporting to the credit bureaus.

Our study also found that as the percent of neighborhood residents with no credit scores increases, so does the level of subprime lending. This is blatantly unfair since large numbers of consumers without traditional credit reports and credit scores are responsible and should qualify for loans at prevailing interest rates. One major reason why a large segment of consumers lack credit scores is that the credit reporting system does not capture non-traditional payment histories such as rental and utility

[3] Remarks by John D. Hawke, Jr., Comptroller of the Currency, Consumers Bankers Association Conference in San Francisco on June 7, 1999, available via http://www.occ.treas.gov.

payments. Congress must require the reporting of these two essential payment history items to the credit bureaus in order to reduce pricing discrimination and make the lending system fairer.

NCRC also recommends that an FCRA renewal bill requires additional studies on credit scoring and fund and promote nationwide financial education initiatives.

Comprehensive Anti-Predatory Legislation

Congress must enact comprehensive anti-predatory lending legislation along the lines of bills introduced by Senator Sarbanes and Representative Schakowsky. Comprehensive and strong anti-predatory lending legislation would eliminate the profitability of exploitative practices by making these practices illegal. It could also reduce the amount of price discrimination since fee packing and other abusive practices would be prohibited. A comprehensive anti-predatory law would also strengthen the Community Reinvestment Act (CRA) if regulatory agencies severely penalize lenders through failing CRA ratings when the lenders violate anti-predatory law.

Congress Must Pass a CRA Modernization Bill

In the 107th Congress, Representatives Luis Gutierrez and Thomas Barrett introduced HR 865, the CRA Modernization Act. This vital bill would increase the rigor of CRA exams by requiring the federal banking agencies to scrutinize the level of lending to minorities as well as low- and moderate-income borrowers. In addition, the CRA Modernization Act would expand CRA to cover independent mortgage companies and all non-depository affiliates of banks. Since price discrimination on the basis of race is prevalent, CRA must be used to prod lenders to offer more

prime loans at prevailing interest rates to minorities. At the same time, expanding CRA to large numbers of lenders would also result in an influx of affordable loans to traditionally underserved communities.

Enhance the Quality of HMDA Data

NCRC believes that Congress and the Federal Reserve Board (which implements the HMDA regulations) must enhance HMDA data so that regular and comprehensive studies can scrutinize fairness in lending. Specifically, are minorities, the elderly, women, and low- and moderate-income borrowers and communities able to receive loans that are fairly priced? While NCRC is confident in the findings of our study, we believe that more information in HMDA data is critical to fully explore the intersection of price, race, gender, and income. HMDA data must contain credit score information similar to the data used in this report. For each HMDA reportable loan, a financial institution must indicate whether it used a credit score system and if the system was their own or one of the widely used systems such as FICO (a new data field in HMDA could contain 3 to 5 categories with the names of widely-used systems). The HMDA data also would contain one more field indicating which quintile of risk the credit score system placed the borrowers.

Using this data, regulators, researchers, the media, and the public could determine if any of the credit score systems were placing minorities and other protected classes in the higher risk categories a disproportionate amount of time. The data would facilitate more econometric analysis to assess whether the prices of loans are based on risk, race, gender, or age. In addition, other critical underwriting variables are needed in the HMDA data including information on debt-to-income ratios and loan-to-value ratios.

Financial Education Critical, Especially for Populations Lacking Credit Scores

In the metropolitan areas examined, about 15 percent of the population lacked credit scores. The percentage was even higher in minority census tracts. A significant finding of this report is that consumers are more likely to receive subprime loans when they lack credit scores. Increased financial education initiatives by Congress, government at all levels, the private sector, and the nonprofit sector are necessary to reach out to the segment of the population that lack credit scores and/or are "unbanked." The segment of the population without credit scores is unlikely to have a fair chance at receiving affordable loans as long as they lack credit histories and remain outside the financial mainstream. In order for financial education to be universal, NCRC recommends that the Department of Education require basic financial literacy to be part of the curriculum of all public schools.

A significant finding of this report is that consumers are more likely to receive subprime loans when they lack credit scores.

Regulatory Recommendations

Federal Agencies Must Step Up Enforcement of Existing Laws to Promote Full Product Choice and Prevent Product Steering

Periodically, the Federal agencies regulating financial institutions will make great fanfare announcing a settlement of a major discrimination lawsuit or the publication of new "interagency" fair lending guidelines. The sad fact, however, is that federal agency efforts to eliminate discrimination and steering creditworthy borrowers to expensive products are failing. The agencies must step up their enforcement of the Equal Credit Opportunity Act, the Fair Housing Act, the Community Reinvestment Act and other fair lending laws in order to ensure full product choice for all Americans.

Halt Preemption of State Anti-Predatory and Consumer Protection Law

The Office of the Comptroller of the Currency (OCC) has preempted Georgia's anti-predatory law for large national banks and has proposed to preempt anti-predatory and consumer protection laws in all states. The OCC's proposed regulations are much weaker in combating abusive practices than state law that would be preempted. At the same time, the Office of Thrift Supervision (OTS) has been preempting anti-predatory law, one state at a time, for federally chartered thrifts. Given the evidence of widespread pricing discrimination, anti-predatory and consumer protection law at all levels need to be strengthened, not weakened. For many decades, banking laws have co-existed on a Federal and state level in many areas such as privacy and disclosures of mortgage terms. This is precisely the wrong time to wipe out critical state anti-predatory and consumer protection law. The credit system is broken, and needs more oversight, not less.

Anti-predatory and consumer protection law at all levels need to be strengthened, not weakened

Federal Reserve Board Must Step Up Anti-Discrimination and Fair Lending Oversight

The General Accounting Office concluded that the Federal Reserve Board has the authority to conduct fair lending reviews of affiliates of bank holding companies. The Federal Reserve Board, however, continues to insist that it lacks this authority.[4] This issue must be resolved because comprehensive anti-discrimination exams of all parts of bank holding companies are critical. Most of the major banks have acquired large subprime lenders that are then considered affiliates and become off-limits to Federal Reserve examination. A pressing question is the extent to

[4] General Accounting Office, *Large Bank Mergers: Fair Lending Review Could be Enhanced with Better Coordination*, November 1999, GAO/GGD-00-16.

which the subprime affiliates refer creditworthy customers to the prime parts of the bank so that the customers receive loans at prevailing rates instead of higher subprime rates. Or does the subprime affiliate steer creditworthy borrowers to high cost loans? These questions remain largely unanswered. Consequently, we do not know the extent to which steering by subprime affiliates and/or their parent banks contributed to the discrimination documented by this report. Thus, it is past time for the Federal Reserve to examine affiliates as well as the parent bank.

Increase Fair Lending Enforcement of Non-Bank Lending

CRA and fair lending reviews cover depository institutions. Large non-bank lenders comprise a significant segment of subprime lenders but are not covered by regular CRA exams and fair lending reviews. As far as we know, neither the Department of Housing and Urban Development, the Department of Justice, nor the Federal Trade Commission has established a proactive program to conduct fair lending investigations of large non-bank lenders. The Department of Justice has settled lawsuits regarding price discrimination with the Long Beach Mortgage Company and other institutions.[5] These lawsuits, however, are usually reactive and in response to complaints or referrals from other regulatory agencies. In cooperation with state regulatory agencies, NCRC calls upon federal agencies to undertake a proactive and aggressive program to enforce the fair lending laws in the case of non-bank lenders.

CRA Exams Must Scrutinize Non-Prime Lending More Rigorously

Currently, CRA exams are not adequately assessing the CRA performance

[5] Department of Justice settlement with Long Beach Mortgage Company, September 5, 1996.

of subprime lenders. For example, the CRA exam of the subprime lender, Superior Bank, FSB, called its lending innovative and flexible before that thrift's spectacular collapse.[6] If CRA exams continue to mechanistically consider subprime lending, subprime lenders will earn good ratings since they usually offer a larger portion of their loans to low- and moderate-income borrowers and communities than prime lenders.

At this point, the regulatory agencies have stated in an "Interagency Question and Answer" document that banks will be downgraded if their lending violates federal anti-predatory law. NCRC has not seen rigorous action to implement this guidance. Fair lending reviews that accompany CRA exams do not usually scrutinize subprime lending for compliance with anti-predatory law, for possible pricing discrimination, or whether abusive loans are exceeding borrower ability to repay. NCRC recommends that all CRA exams of subprime lenders must be accompanied by a comprehensive fair lending and anti-predatory lending audit. In addition, CRA exams must ensure that prime lenders are not financing predatory lending through their secondary market activity or servicing abusive loans.

NCRC also recommends that any bank or thrift whose subprime lending exceeds a nominal amount such as 5 percent of its total loan amount must have a separate prime and subprime CRA lending exam. As NCRC stated in our comment letter during the Advance Notice of Proposed Rulemaking on the CRA during the fall of 2001, a bank or thrift must not pass its lending test if it does not score at least a satisfactory rating on the

[6] Office of Thrift Supervision Central Region's CRA Evaluation of Superior Bank, FSB, Docket #: 08566, September 1999. Available via http://www.ots.treas.gov, go to the CRA search engine and select "inactive" for the status of the institution being searched.

prime portion of its lending test. The lending test is currently the most important part of CRA exams for large banks and the only element of small bank exams. Prime lending must likewise be elevated as the most important part of the lending test. NCRC's study contributes to a significant amount of evidence that minority communities receive too much subprime lending due to discrimination. In order to correct for market failure and increase product choice in underserved communities, NCRC believes that prime lending must be emphasized on CRA exams.

Full Disclosure of Automated Underwriting Systems

This report focused on the impact of credit scores as well as race and age composition of neighborhoods in determining the level of subprime lending. Automated underwriting systems use credit scores and variables similar to the ones in this report in guiding financial institutions in their lending decisions. Since our report found a substantial amount of price discrimination, we believe that automated underwriting systems must be made more transparent in order to assess whether they are contributing to discrimination. Factors and the weights of factors used by the automated systems must be disclosed. The Department of Housing and Urban Development must release the results of its fair lending examination of Fannie Mae's and Freddie Mac's automated underwriting systems.

Recommendations for Lenders, Community Groups, and Consumers

Lenders Must Adopt Risk-Based, Not Race-Based or Age-Based Pricing: Best Practices Needed

This report finds that discrimination on the basis of race and age is wide-

spread in America. Too many subprime lenders disregard risk, as measured by credit scores, in pricing their loans. NCRC calls upon the lending industry to adopt comprehensive best practices so that they can avoid pricing discrimination and other predatory practices. The best practices approach must also include rigorous compliance training for loan officers as well as mystery shopping and testing initiatives to identify and eliminate discriminatory practices. NCRC is in the process of completing a mystery shopper report that documents the need for additional industry compliance efforts because the report reveals disparate treatment regarding interest rate and loan terms for white and minority testers.

Community Groups Must Advocate and Offer Financial Education and Counseling Programs

NCRC's findings reinforce the need for community group advocacy as well as program delivery. Community groups must be active in the CRA process, offering comments during CRA exams and merger applications, particularly when they believe a lender is violating fair lending law and discriminating against minorities, women, and the elderly. Each time a community group and/or coalitions of community groups change the practices of a major lender (engaged in both prime and subprime lending), the impact on the industry as a whole is profound and cannot be underestimated. At the same time, community groups should continue pursuing programmatic opportunities, including mystery shopping, financial education, and counseling programs. Community groups should increase their skill and sophistication of using data compiled from their program delivery for their advocacy and policy positions.

Consumers Must Shop for Affordable Loans and Obtain Credit Reports, Credit Scores, and Pursue Inaccuracies

NCRC recommends that consumers consult with NCRC's *Best and Worst Lenders* at http://www.ncrc.org to find a list of lenders most likely to approve minorities, women, and low- and moderate-income consumers for affordable loans. *Best and Worst Lenders* provides detailed information on lenders in 25 major metropolitan areas. Consulting with *Best and Worst Lenders* increases the chances that consumers will be approved for loans. In addition, *Best and Worst Lenders* enables consumers to identify responsible banks that reinvest consumer deposits back into minority and low- and moderate-income communities instead of redlining local communities and investing their deposits elsewhere.

Once a year, consumers should also purchase their credit reports and scores from each major credit bureau (Experian at www.experian.com, Equifax at www.equifax.com; and Trans Union at www.transunion.com). If a consumer believes that his or her credit report contains an inaccuracy, he or she should ask the credit bureaus to investigate and correct any mistakes. If the consumer believes that the credit bureaus have not fairly resolved disputes over mistakes, he or she should contact the Federal Trade Commission at www.ftc.gov.

Background and Literature Review

NCRC benefited from industry data on creditworthiness in order to produce a comprehensive study on the relationship between loan pricing and the race and age of neighborhoods. NCRC used credit scoring data provided by one of the three large credit bureaus. A credit score is a numerical score estimating the chances a consumer will be delinquent in loan payments or default altogether. The credit score is derived from statistical analysis of information contained in credit reports regarding a

consumer's past payment history and use of credit. On a census tract level, the credit scoring data indicated how many consumers were in various categories of risk. NCRC was then able to analyze the impact of credit scores on the level of subprime home lending by combining the credit scoring information with the Home Mortgage Disclosure Act (HMDA) data, and demographic and housing stock data from the Census Bureau.

NCRC employed regression analysis to predict the level of subprime lending on a census tract level in ten large metropolitan areas. The analysis allowed NCRC to determine whether increases in the African-American, Hispanic, or elderly population in a neighborhood led to increases in the amount of subprime loans after controlling for credit-worthiness (as revealed by the credit score data) and important housing stock characteristics. As stated above, the findings revealed that minority and elderly neighborhoods do, in fact, receive substantially higher levels of subprime lending than is justified based on the creditworthiness of their residents, housing values, and other measures of housing market conditions.

NCRC's findings are consistent with a body of research on subprime lending. A recent survey study conducted by Freddie Mac analysts finds that two-thirds of subprime borrowers were not satisfied with their loans, while three-quarters of prime borrowers believed they received fair rates and terms.[7] In previous years, Freddie Mac and Fannie Mae have often been quoted as stating that between a third to a half of

[7] Freddie Mac analysts Marsha J. Courchane, Brian J. Surette, Peter M. Zorn, *Subprime Borrowers: Mortgage Transitions and Outcomes*, September 2002, prepared for Credit Research Center, Subprime Lending Symposium in McLean, VA.

borrowers who qualify for low cost loans receive subprime loans.[8] Dan Immergluck, a professor at Grand Valley State University, was one of the first researchers to document the "hypersegmentation" of lending by race of neighborhood.[9] Like Immergluck's work, the Department of Housing and Urban Development found that after controlling for housing stock characteristics and the income level of the census tract, subprime lending increases as the minority level of the tract increases.[10] The Research Institute for Housing America, an offshoot of the Mortgage Bankers Association, released a controversial study in 2000 which concluded that minorities were more likely to receive loans from subprime institutions, even after controlling for the creditworthiness of the borrowers.[11]

A recent survey study conducted by Freddie Mac analysts finds that two-thirds of subprime borrowers were not satisfied with their loans,

NCRC's study is quite similar and builds upon important research conducted by a Federal Reserve economist and two researchers from the Wharton School at the University of Pennsylvania. Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School also use credit scoring data to conduct econometric analysis scrutinizing the influence of credit scores, demographic characteristics, and economic conditions on the level of subprime lending. Their study found that after controlling for creditworthiness and housing market

[8] "Fannie Mae Vows More Minority Lending," in the Washington Post, March 16, 2000, page E01. Freddie Mac web page, http://www.freddiemac.com/corporate/reports/moseley/chap5.htm.

[9] Dan Immergluck, *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development*, the Woodstock Institute, November 1999.

[10] Randall M. Scheessele, *Black and White Disparities in Subprime Mortgage Refinance Lending*, April 2002, published by the Office of Policy Development and Research, the U.S. Department of Housing and Urban Development.

[11] Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why?* Working Paper No. 00-03, published by the Research Institute for Housing America, September 2000.

conditions, the level of subprime refinance and home purchase loans increased in a statistically significant fashion as the portion of African-Americans increased on a census tract level in Philadelphia and Chicago.[12]

Relatively few studies examine the relationship between the number of elderly residents of a neighborhood and the level of subprime lending although anecdotal evidence suggests that abusive lenders target the elderly. In one study, the South West office of Consumers Union found that every 1 percentage point increase in the portion of people over 65 in a neighborhood increased subprime refinance lending by 1.3 percentage points. The Consumers Union study examined neighborhoods in Dallas and Austin, and included demographic variables and a few underwriting variables such as loan amount to income ratios in its regression equations.[13] The AARP also conducted a national survey of elderly borrowers and found that older borrowers who were widowed, female, African-American, and less educated were more likely to receive subprime loans than their married, male, white, and more educated counterparts. The survey also found that seniors receiving subprime loans were more likely to have been approached by brokers, to have refinanced two or more times in the past three years, and to be dissatisfied with their loans.[14]

Another body of literature examines whether consumer credit reports are

[12] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov.

[13] Consumers Union, *Elderly in the Subprime Market*, October 2002, www.consumersunion.org.

[14] Neal Walters and Sharon Hermanson, *Older Subprime Refinance Mortgage Borrowers*, AARP Public Policy Institute, Data Digest Number 74, July 2002, http://www.aarp.org/ppi.

accurate. If consumer credit reports are incomplete and inaccurate, then the credit scores used to assess risk could be seriously flawed. Troubling evidence suggests that substantial inaccuracies exist in credit reports and could be contributing to racial disparities in lending. In the summer of 2002, the Consumer Federation of America (CFA) shed more light on how credit report flaws can disproportionately impact borrowers on the edge between prime and subprime credit. CFA's analysis of credit scores in more than 500,000 merged credit files revealed that 29 percent of consumers had scores with a range of at least 50 points when using the credit reports from each of the three major bureaus. Focusing in more detail on 1,704 at-risk mortgage purchasers with marginal scores between prime and higher cost subprime credit, CFA found that at least one-fifth would be harmed, and one-fifth would benefit from score inaccuracy if they tried to purchase mortgage loans. The upshot of this finding is that at least 8 million Americans may be erroneously placed into subprime loans and thus pay tens of thousands of dollars each in unnecessarily high mortgage interest payments.[15]

In the winter of 2003, a Federal Reserve Bulletin article revealed that almost one third of sampled credit accounts lacked information on borrower credit limits, which is a key variable for credit scores. Furthermore, subprime specialists reported credit limits 77 percent of the time for their prime customers, but only 40 percent of the time for their subprime customers.[16] Not reporting the credit limit makes borrower credit appear

[15] Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implication for Consumers*, December 2002, http://www.consumerfed.org.

[16] Robert B. Avery, Paul S. Calem, Glenn B. Canner, Raphael Bostic, *An Overview of Consumer Data and Credit Reporting*, Federal Reserve Bulletin, February 2003, http://www.federalreserve.gov.

to be much worse than it actually is. The absence of this information results in borrowers appearing to be much closer to fully utilizing their credit cards and other open ended credit than they are in reality.

The findings of NCRC, the Calem, Gillen, and Wacther study, as well as other research, are disturbing but not surprising. Predatory lenders brazenly disregard credit scores and also do not engage in other conventional and prudent underwriting techniques. They discriminate by offering minority and elderly borrowers higher interest rate loans than is justified based on credit scores. At the same time, credit scores are not accurately predicting risk due to omitted variables that are key for traditionally underserved populations. In short, the credit system is broken and discrimination will only be eliminated if the recommendations outlined above are implemented.[17]

Methodology

As stated above, the key goal of the analysis is to determine the relationship between the portion of minority and elderly persons in a census tract and the percentage of home purchase and refinance loans that are made by subprime lenders. After controlling for economic and risk factors, does the portion of subprime loans increase as the minority and elderly population in a census tract increases? In other words, this study explores the likelihood of discrimination and reverse redlining in home

[17] Given the problems with credit reports, the credit scores used here are more likely to overstate risks for minority borrowers than for white borrowers. Accordingly, the scores are more likely to overstate the percent of borrowers in high risk groups in African-American rather than white census tracts. If such bias does occur in scores, then the use of these scores means that the true impact of race on subprime lending is higher than that indicated by the results found here. That is, our estimates of discrimination or redlining are biased low. The credit report and score data needs to be improved via renewal of Fair Credit Reporting Act.

lending. NCRC chose 10 metropolitan statistical areas (MSAs) from different parts of the United States and conducted a statistical analysis in each area. In particular, the MSAs selected are: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington DC. These areas have different demographic and economic characteristics, which will allow us to make credible and generalizable conclusions about the home lending patterns across large metropolitan areas. In the ten MSAs, the sample consists of about 7,000 census tracts (6,741 for home purchase and 7,097 for refinance). A multivariate regression approach controlled for demographic and risk factors.

NCRC conducted separate analyses for home purchase and refinance lending. We expected a higher degree of pricing disparities by race and age of neighborhood in refinance lending since subprime lenders specialize in refinance lending and make fewer home purchase loans. NCRC's previous work, including *Best and Worst Lenders*, also found more disparities in refinance lending than home purchase lending. Abusive subprime lenders are particularly active in refinance lending since their intention is to strip equity from homeowners through repeated refinancings or flipping.

Variables for the analysis belong to three categories: home lending, credit scoring, and demographics. NCRC used 2001 HMDA data for home lending, 1999 credit scoring data, and 1990 census tract demographic information. NCRC obtained the 1999 credit scoring data on a one-time basis from one of the three large credit bureaus. NCRC chose 2001 HMDA data, not 1999 data, as we believe that the distribution of credit scores on a census tract level does not vary significantly over a three year time period. NCRC ran regression equations using 1999 and 2000 home

loan data to confirm the hypothesis. The results were similar over the years. Also, 2001 was a year of lower interest rates. NCRC wanted to see if minority neighborhoods were benefiting from lower interest rates as measured by a decrease in the statistical significance of race of neighborhood on the level of subprime lending. NCRC would have preferred to use 2000 census tract data, but the HMDA data will not use 2000 census data until the 2003 release in the summer of 2004. The 2001 HMDA data uses 1990 census tract boundaries. NCRC believes the results will be similar with HMDA data using 2000 census tract boundaries, but we intend to do follow-up research.[18]

HUD Subprime and Manufactured Home Lender List

In order to classify loans as subprime, NCRC used a list of subprime and manufactured home lenders developed by HUD. Since HMDA data does not have information on the Annual Percentage Rate (APR) or other loan terms and conditions, HUD developed its list by complementing data analysis with interviews of lending institutions and a literature search. As an additional step, HUD called the lenders on its list and asked them if they considered themselves subprime and manufactured home specialists. Generally speaking, a lender was included on the list if more than 50 percent of the loans in its portfolio was subprime or manufactured home.[19]

[18] Important characteristics of the HMDA data are discussed separately in an appendix.

[19] HUD itself admits that the list is not complete. A number of institutions considered to be prime specialists make a significant number of subprime loans, even if 50 percent or more of their loans are not subprime. Also, the list may not be complete due to name changes and omissions. HUD refines its lists on an annual basis and also corrects mistakes on previous years' lists. HUD's web page (http://www.huduser.org/datasets/manu.html) has more information about the lists and has copies of the lists.

Until more information on loan terms and conditions are available in HMDA data, HUD's list is a valuable resource for conducting subprime and manufactured home loan analysis. Although the list is incomplete, it still captures significant differences in lending behavior as revealed by this report and a substantial body of research.

Data and variables

Home lending data in the analysis represents only originations of home loans, not applications for the loans. We included all types of loans: conventional, and government insured (FHA, VA, and FSA/RHS) to owner-occupants only. NCRC also separated two types of home loans: home purchase loans and refinance loans. By doing so, we aimed to see for which loan type the race and age of neighborhood residents had a stronger influence. We excluded manufactured home lenders from the analysis as initial regressions revealed that the level of manufactured home lending did not vary in a statistically significant manner with the race of neighborhood residents.[20] Future research should explore this in more detail. The study excluded census tracts in which the number of originated loans was less than 20. This was done to ensure a sufficient number of loans for meaningful characterization of each tract's lending patterns.

[20] Manufactured home lenders specialize in making loans to borrowers purchasing manufactured homes. These lenders tend to make high interest rate loans; abusive lending has been widespread in the manufactured home sector as indicated by massive foreclosures and the failures of large national manufactured home lenders. According to HUD, "A manufactured home (formerly known as a mobile home) is built to the Manufactured Home Construction and Safety Standards (HUD Code) and displays a red certification label on the exterior of each transportable section. Manufactured homes are built in the controlled environment of a manufacturing plant and are transported in one or more sections on a permanent chassis." HUD has detailed information about manufactured housing on its web page of http://www.hud.gov.

The analysis chose the following variables that would hypothetically influence subprime lending in an area.

Home lending variables (dependent variables):

%subHP – percent of home purchase loans in a census tract that were subprime.

%subREF – percent of refinance loans in a census tract that were subprime.

Demographic variables included:

%black – percent of residents in a census tract who were African-American;

%hisp – percent of residents in a census tract who were Hispanic;

%65age – percent of residents in a census tract who were over 65 years old;

medage – dummy variable. The variable revealed the median age of houses in a census tract.

0 when the median age of housing was between 0-20 years old (built in 1970-1990);
1 when the median age of housing was between 21-50 years old (built in 1969-1940);
2 when the median age of housing was 51 years and older (built before 1940);

medhhinc – 1989 median household income in a census tract;

HT – housing turnover. This variable is a ratio of all home purchase loans made in 2001 divided by owner occupied units in 1990. The literature indicates that a higher amount of housing turnover (as revealed by larger values of this variable) suggests a more vibrant market and faster home value appreciation. This should make a census tract more attractive to prime lenders and thus decrease the portion of subprime lending.

capitaliz – The "capitalization" variable is a ratio of gross median rent divided by median housing value. The literature suggests that owner-occupied units appreciate slower in neighborhoods where the median rent is higher relative to the median housing value (higher ratio values for this variable). Therefore, prime lenders may find neighborhoods less attractive with higher values for the capitalization variable, meaning that the portion of subprime loans will be higher in these neighborhoods.

Credit scoring variables included:

%vhigh – is a credit score variable that indicated the percent of people in a census tract in the very high credit risk category;

%NC – is the percent of neighborhood residents lacking credit scores;

vh+h+m – the cumulative percent of neighborhood residents in very high, high, and moderate credit risk categories added together.

The credit risk scores used in this report measure the likelihood of future delinquencies and foreclosures. The database had a credit score range from 0 to 1,000 with lower scores indicating lower risk or chance of borrower delinquency. The scores were divided into five equal categories or quintiles of risk; the specific categories are Very Low, Low, Moderate, High and Very High risk. The credit score range was separated into quintiles, not the population totals within the quintiles. In other words, each score quintile did not have equal numbers of people, but each score range was of equal length (about 200 units for each quintile since the total range is from 0 to 1,000).

For each census tract, the database contains the number and percent of neighborhood residents in each of the five risk categories, and the number and percent of neighborhood residents with no credit scores.

NCRC's analysis focuses on the "vh+h+m" credit score variable. Our regression analysis was iterative. One equation (Column 1 on Tables 1 through 10) included the combined risk variable of "vh+h+m" and the NC or no credit score variable. Column 2 is another regression in which the very high risk and no credit score variables are included as separate variables (see the tables below).

Columns 3 through 4 repeat the iterative approach for the risk variables in the same order as Columns 1 through 2. The difference between Columns 1 and 2 and Columns 3 and 4 is that the race and age variables are omitted in Columns 3 and 4. This is done in order to understand better the added explanatory power obtained by including the race and age variables (see discussion below in the Functional Form section).

The "vh+h+m" variable was statistically significant across all ten MSAs for home purchase lending and nine MSAs for refinance lending. The impact of the variable was as expected; that is, subprime lending was more prevalent as the percentage of people in a census tract with very high, high, and moderate risk increased. The regression equations including only the very high risk and no credit score variables had very similar outcomes to the equations with the "vh+h+m" combined risk and no credit score variables. Although the very high risk equations (Column 2) were similar to the "vh+h+m" equations (Column 1), we focused on the "vh+h+m" equations since subprime lenders would likely make loans to consumers with high and moderate risk as well as very high risk. The coefficients and R squares in the "vh+h+m" equations were consistent with these expectations.

In contrast to our report, the Calem, Gillen, and Wacther study focuses on the equations with the very high risk and no credit score variables. The fact that two different series of equations (those with very high risk and no credit score variables and those with the combined risk and no credit score variables) produced similar results adds to the robustness of the overall findings.

Impact of Demographic Versus Economic Factors

As stated above, we conducted multivariate regression analysis with the dependent variable represented by the percentage of subprime loans in a census tract and independent variables that control for demographic, economic and risk factors. Our variables of interest were the minority and elderly populations in a census tract. NCRC hypothesized that the percent of minorities and elderly people in a census tract was positively related to the percent of subprime loans originated in a census tract.

Table 11 shows the statistical significance of variables at the 10%, 5%, and 1% precision level, sign of estimated coefficients, and adjusted R square for every regression. The adjusted R square was rather high for most MSAs and loan types (the higher the R square, the better the equation accounts for and explains patterns of subprime lending on a neighborhood level). The R square was higher for refinance than home purchase, suggesting that our model was better at predicting patterns in refinance lending. For refinance lending, the R square ranged from 0.5252 in Los Angeles to 0.8993 in Detroit. For home purchase lending, the R square fell between 0.0843 in Baltimore and 0.6865 in Cleveland. The R square was above 0.3 in five out of ten MSAs in home purchase lending. In contrast, the R square was above 0.3 in all MSAs in refinance lending. Overall, we believe our model is robust and a good predictor of lending patterns. The model's results were consistent with the Calem, Gillen, and Wachter study.

. . .the percent of minorities and elderly people in a census tract was positively related to the percent of subprime loans originated in a census tract.

The African-American population in a census tract was statistically significant in six MSAs for home purchase lending and in nine MSAs for

refinance lending. As expected, after controlling for risk and housing stock characteristics, the effect of the percentage of African-American population on the portion of subprime loans in a census tract was positive in all MSAs. Lenders still associated high risk with race and thus, compensated by making a substantially higher level of subprime loans in African-American than white tracts.

The percent of Hispanic population in a census tract was significant in only one MSA for home purchase and in five MSAs for refinance lending. The sign of the coefficients was not consistent for each MSA.[21] The sign was negative in one MSA for home purchase lending and in two MSAs for refinance lending. In contrast, the sign was positive in three MSAs for refinance lending, meaning that the level of subprime refinance lending increased as the portion of Hispanics increased in a census tract. Our study results suggest no consistent relationship between the level of subprime lending and the portion of Hispanics in a neighborhood. However, the portion of Hispanics in a neighborhood was associated with an increase in subprime lending, all else equal, in a subset of the MSAs.

The portion of people over 65 was a strong factor for three out of ten MSAs for home purchase lending. For refinance lending, the age of the census tract population was significant in eight MSAs. For refinance and

[21] A coefficient expresses the effect of an independent variable on the dependent variable. In this report, the portion of subprime loans is the dependent variable. The level of subprime lending changes because of the racial composition of the neighborhood and other "independent" variables. For the racial composition of the neighborhood, the coefficient measures the impact in percentage point terms. For every percentage point increase in African-American or Hispanic residents in a census tract, the portion of subprime loans increases or decreases by a certain number of percentage points as revealed by the value and sign of the coefficient. The coefficient only has an impact if it is statistically significant (as revealed by legends in the charts capturing the regression results).

home purchase lending, the sign of the coefficients was positive in all MSAs except in two of the eleven cases. This supports the contention that abusive lenders target the elderly to take advantage of the fact that the elderly have substantial amounts of equity but are often short on cash. These results contradict those obtained by Calem, Gillen, and Wachter. They mentioned that this variable "yielded no additional insights," but their study looked at only two MSAs.

Median household income of a census tract was statistically significant in four out of ten MSAs in home purchase lending and in refinance lending. Except in one case, the sign of the coefficients was positive, which is counterintuitive. The literature, however, discusses that a segment of high income borrowers do not report income level to lenders nor do they want to undergo a lengthy application process. Hence, they receive subprime loans. It must be added that the coefficient values were very small, meaning that the income variable had a small impact on the level of subprime lending in census tracts.

Except for Detroit refinance lending, the combined risk variable in all MSAs for both loan types was statistically significant. Coefficients were positive, meaning that a larger percentage of people with higher risk factors was associated with a higher percent of subprime loans in a census tract. These findings are quite consistent with those discussed in the Calem, Gillen, and Wachter report. Also, the level of subprime home purchase and refinance lending increased in a statistically significant fashion in the great majority of MSAs as the percentage of neighborhood residents with no credit scores increased.

The other variables including housing turnover and capitalization be-

haved in the expected manner. Housing turnover was significant in most MSAs and the coefficients' signs were negative, which supported our expectations. Higher housing turnover indicates more vibrancy in the market of the neighborhood, which in turn leads to less subprime lending. The capitalization variable was significant in six MSAs for home purchase and in ten MSAs for refinance lending. Except in one case, it also had the expected effect on subprime lending. Specifically, it was positively related to the percent of subprime loans, proving that faster appreciation of the owner-occupied units (smaller capitalization ratios) leads to less subprime lending in a neighborhood.

Subprime lending increased significantly as the portion of African-Americans and elderly people increased in a neighborhood.

In summary, after controlling for risk and housing stock characteristics, subprime lending increased significantly as the portion of African-Americans and elderly people increased in a neighborhood. Pricing discrimination is widespread in the dual lending marketplace in America.

Metropolitan Areas Compared

Tables 12 through 14 sort MSAs by the effect of race and age factors on the level of subprime home purchase and refinance lending in a census tract. As Table 12 reveals, the percentage of African-Americans in a census tract imposed the strongest effect on subprime home purchase lending in Cleveland, Milwaukee, Detroit, and Atlanta. The African-American variable had the largest effect in Houston, Milwaukee, Detroit, and Cleveland for refinance lending. For example, in Houston a ten percentage point increase of African-Americans in a census tract, holding all other variables constant, would lead to an increase in the portion of subprime refinance loans of 4.058 percentage points. In contrast, in Baltimore a 10 percentage point increase in the portion of African-Ameri-

cans would lead to only a 1.107 percentage point increase in the portion of subprime refinance loans.

In Tables 12 through 14, the coefficients with one, two, or three asterisks are coefficients estimated at the 10%, 5%, and 1% level of statistical significance, respectively. In other words, these coefficients are valid in predicting the portion of subprime loans. In contrast, when the coefficients do not have asterisks, they cannot be used to predict the level of subprime loans.

The coefficient values for the African-American variables in this report are consistent with those in Calem, Gillen, and Wachter. The ordinary least squares regressions in the Calem, Gillen, and Wachter study estimated the African-American coefficient at about 0.2, which was approximately the median coefficient in our equations as reported in Table 12.

The portion of Hispanics in a census tract had the strongest impact in the Detroit and Houston MSAs for refinance lending, according to Table 13. In Detroit for example, a 10 percentage point increase in the Hispanic population would lead to 1.282 percentage point increase in the portion of subprime refinance lending.

The portion of people over 65 was a relatively strong variable in Detroit and Houston for home purchase lending and in St. Louis, Atlanta, and Houston for refinance lending. In particular, in the St. Louis MSA, a 10 percentage point increase of people over 65 would lead to a 3.065 percentage point increase in the portion of subprime refinance loans in a neighborhood.

In refinance and home purchase lending, the African-American portion of people in a census tract increased subprime lending regardless of the level of segregation in a MSA (see Table 12 which shows segregation levels as well as estimated coefficients for the African-American variable). For African-Americans, discrimination poses great difficulties across a wide swath of MSAs of different economic and demographic conditions. Regardless of the level of segregation, the African-American variable increased subprime refinance lending. No trends appeared regarding the level of segregation and the impact of the Hispanic variable on the amount of subprime lending.

Functional Form

Another dimension that should be discussed in this analysis is functional form: how it affects the results and what conclusions it informs. As stated above, NCRC used two forms when running the regressions: including and excluding race and age factors. The outputs are presented in the Tables 1 through 10. In most cases, the R square was lower when the race and age variables were excluded (this is observed clearly when comparing Columns 1 and 3 with the vh+h+m combined risk variable). This suggests that the equations explained a greater amount of the variation in the dependent variable when the race and age variables were included.

Calem, Gillen, and Wachter took a different iterative approach, but their findings were similar to our study. They ran some regressions with only demographic characteristics while we ran some regressions with only non-race variables. The end result of both approaches was that the R square was higher when the race variables were included.

Conclusion

After controlling for risk and housing market conditions, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending. The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas. The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood. In America today, lenders engage in widespread price discrimination, making high cost loans based on the race and age of neighborhoods, not solely based on risk.

Appendix

HMDA Data: Its Strengths and Weaknesses

Enacted by Congress in 1975, the Home Mortgage Disclosure Act (HMDA) requires banks, savings and loan associations, credit unions, and other financial institutions to publicly report detailed data on their home lending activity. Under HMDA, lenders are required to disclose annually the number of loan applications by census tract, and by the income, race, and gender of the borrower. The law also requires institutions to indicate the number and dollar amount of the loans made.

Prior to 1990, lenders were required to report the census tract containing

the property for which the applicant succeeded or failed in obtaining a home loan. The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) required lenders to report the race, gender, and income of loan applicants and borrowers starting in 1990. Thus, HMDA data before 1990 reveals information only on the census tract location of the application or loan, whereas HMDA data after 1990 includes information on borrower characteristics. Also, starting in 1993, independent mortgage companies were required to report HMDA data.

HMDA requires lenders to report on a number of possible actions or "dispositions" on loan applications. Each year, the lender must report the number of loan applications it approved and denied. The lender must also indicate how many of its loan approvals were unaccepted (the bank approved the application but the applicant did not want the loan). Finally, the lender must specify how many applications were withdrawn (the applicant withdrew his application before the bank made a credit decision), and how many applications were incomplete (the application was not considered because the applicant did not provide all the necessary information).

Housing loans covered by HMDA include home purchase, home improvement, and refinance loans for single family dwellings (1 to 4 units) and loans for multi-family units. Lenders must disclose whether the loan was a conventional loan or a loan insured by a government agency such as the Federal Housing Administration (FHA), the Veterans Administration (VA), the Farm Service Agency (FSA), and the Rural Housing Service (RHS). Additional information reported includes the occupancy status of the property (owner occupied or non-owner occupied). The lender must also indicate if the loan was purchased on the secondary market and the

type of institution that bought the loan (for example, another bank or Fannie Mae or Freddie Mac).

Who is Covered by HMDA

A depository institution (bank, thrift, and credit union) must report HMDA data if it has a home office or branch in a metropolitan statistical area (MSA) and has assets above a threshold level that is adjusted upward every year by the rate of inflation. Before 1997, small depository institutions were exempt if they had assets less than $10 million. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended HMDA to adjust the exemption level to take into account annual inflation as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers. For the 1997 data, the asset level for exemption was increased from $10 million to $28 million (to take into account inflation occurring between 1975, the first year of HMDA data, through 1996). For 1998 and 1999 data collection, the Federal Reserve increased the asset level for exemption to $29 million. For the year 2000 and 2001, the Federal Reserve set the asset level for exemption to be $30 million and $31 million, respectively.

In addition, a depository institution is not required to report HMDA data if it did not make a home purchase loan on a 1-to-4 unit dwelling (or if it did not refinance a home purchase loan) during the previous calendar year.

Many non-depository institutions must also report HMDA data. An example of a non-depository institution is a mortgage company that does not accept deposits but raises funds for lending by borrowing from

investors. A non-depository institution must report HMDA data if it has more than $10 million in assets and it originated 100 or more home purchase loans (including refinances of home purchase loans) during the previous calendar year. A non-depository institution is exempt from HMDA reporting requirements if its home purchase loans (including refinances of home purchase loans) were less than 10 percent of all of its loan originations, measured in dollars, during the previous calendar year.

Gaps in HMDA Data

Small lenders and lenders with offices only in non-metropolitan areas (as noted above) are exempt from HMDA data reporting requirements. Data for rural areas is also incomplete, particularly information on the census tract location of loans. If banks and thrifts have assets under $250 million dollars (or are part of holding companies under $1 billion dollars), they do not have to report the census tract location for loans in MSAs (metropolitan statistical areas) in which they do not have any branch offices. They also do not have to report the census tract location for loans outside of MSAs.

Non-depository institutions do not have to report the census tract location of loans made in non-metropolitan areas. They have to report the census tract location of loans in those MSAs in which they received applications for, originated, or purchased five or more home purchase or home improvement loans during the preceding calendar year.

Another area of incompleteness concerns race and gender data of applications taken via the telephone. When applications are made in person, the loan officer is required to ask the applicant about his/her race. If the

applicant refuses, the loan officer is required to record race on the basis of visual observation or applicant surname. The loan officer is required to inform the applicant that federal law designed to combat discrimination requires this information. In contrast, when applications are received over the phone, the loan officer is not required to ask for the race and gender of the applicant (but this is about to change, see immediately below). When applications are received through the mail, the lending institution is required to ask for the race and gender of the applicant.

In the case of the electronic media, the official staff commentary of the Federal Reserve Board regarding the HMDA regulation states that lenders are required to ask for race and gender when applications are received over the Internet. When lenders are using electronic media with a video component, lenders are to use the same procedures as if the application is made in person.

Finally, a lender is not required to report the race, gender, and income data for loans that they purchase from another institution.

Improvements in HMDA Data

In the summer of 2002, the Federal Reserve Board made some significant changes to HMDA (the Federal Reserve Board has statutory responsibility to promulgate HMDA regulations). Lending institutions will be required to ask borrowers applying over the phone for their race and gender, starting in 2003.

In 2004, non-depository institutions making at least $25 million in home purchase loans will be required to report HMDA data. This will capture

more non-depository institutions as HMDA reporters than the thresholds described above. Lending institutions will be required to indicate in the HMDA data if the loans were for manufactured homes or traditional single family residences. The Federal Reserve Board will also require lenders to report price information if the APR on their loans exceeds the rate on Treasury securities by three percentage points for first-lien loans and five percentage points for second-lien loans.

Other changes to HMDA data beginning in 2004 include improving the definition of home improvement and refinance loans, requiring an indication if a loan is covered by the Home Ownership and Equity Protection Act, and requiring pre-approvals to be reported for home purchase loans. Finally, but importantly, lenders will be required to indicate the identity of their parent companies in the HMDA data.

Table 1: Detailed Regressions for Atlanta

Atlanta - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					Variable
Intercept	-0.0736	0.0001	-0.2301	-0.0743	Intercept
	-1.6899	0.0057	-6.9928	-3.4637	
%black [est. coeff.]	0.1393	0.1327			%black
[t-Score]	***8.4146***	***7.4253***			
%hisp [est. coeff.]	-0.2080	-0.2475			%hisp
[t-Score]	-1.3761	-1.6392			
%65age [est. coeff.]	0.0845	0.0404			%65age
[t-Score]	1.2000	0.6217			
medage [est. coeff.]	-0.0060	-0.0052	0.0114	0.0104	medage
[t-Score]	-0.9145	-0.7775	*1.7122*	1.6101	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	**2.0566**	1.6146	***3.8901***	***3.1293***	
HT [est. coeff.]	-0.0007	0.0000	-0.0042	-0.0034	HT
[t-Score]	-0.3130	-0.0374	**-1.9974**	*-1.6600*	
capitaliz [est. coeff.]	2.2945	2.3405	0.3412	0.0582	capitaliz
[t-Score]	1.3955	1.4269	0.1905	0.0336	
%vhigh [est. coeff.]		0.1635		0.4289	%vhigh
[t-Score]		***2.8298***		***8.9836***	
% NC [est. coeff.]	0.0756	-0.0036	0.5576	0.2826	%NC
[t-Score]	0.8172	-0.0403	***7.3417***	***3.4278***	
vh+h+m [est. coeff.]	0.1621		0.3740		vh+h+m
[t-Score]	***2.8550***		***7.7943***		
Adj R-square	0.4566	0.4564	0.3429	0.3684	**Adj R-square**

Atlanta - Refinance

Variable					Variable
Intercept	-0.2316	-0.0823	-0.4070	-0.1572	Intercept
	-4.9917	-3.1144	-10.8020	-6.5746	
%black [est. coeff.]	0.1886	0.1682			%black
[t-Score]	***11.1936***	***9.2579***			
%hisp [est. coeff.]	-0.2456	-0.3350			%hisp
[t-Score]	-1.5388	**-2.1166**			
%65age [est. coeff.]	0.2701	0.1899			%65age
[t-Score]	***3.6791***	***2.8195***			
medage [est. coeff.]	0.0016	0.0043	0.0325	0.0310	medage
[t-Score]	0.2257	0.6160	***4.2526***	***4.3506***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***2.7783***	**1.9990**	***4.0840***	***3.1652***	
HT [est. coeff.]	-0.0021	-0.0008	-0.0065	-0.0052	HT
[t-Score]	-0.8715	-0.3277	***-2.7204***	**-2.3121**	
capitaliz [est. coeff.]	7.9826	7.7769	5.7983	4.8837	capitaliz
[t-Score]	***4.7224***	***4.6556***	***2.9185***	***2.6230***	
%vhigh [est. coeff.]		0.3827		0.7148	%vhigh
[t-Score]		***6.2345***		***13.6511***	
%NC [est. coeff.]	0.1760	0.0061	0.8036	0.3462	%NC
[t-Score]	*1.8166*	0.0654	***9.1324***	***3.7494***	
vh+h+m [est. coeff.]	0.3458		0.6046		vh+h+m
[t-Score]	***5.6966***		***11.0804***		
Adj R-square	0.6903	0.6944	0.5654	0.6091	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 2: Detailed Regressions for Baltimore

Baltimore - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0274	0.0012	-0.0174	0.0128	Intercept
	-0.9384	0.0629	-0.9437	0.8683	
%black [est. coeff.]	0.0063	-0.0096			%black
[t-Score]	0.5582	-0.7825			
%hisp [est. coeff.]	-0.0890	-0.1080			%hisp
[t-Score]	-0.5333	-0.6547			
%65age [est. coeff.]	0.0367	0.0270			%65age
[t-Score]	0.9263	0.7600			
medage [est. coeff.]	0.0014	0.0017	0.0027	0.0026	medage
[t-Score]	0.3706	0.4567	0.7710	0.7620	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.6878	1.1145	0.4214	0.7548	
HT [est. coeff.]	-0.0209	-0.0133	-0.0267	-0.0164	HT
[t-Score]	-1.0024	-0.6474	-1.3083	-0.8145	
capitaliz [est. coeff.]	-1.5117	-2.3430	-1.4297	-2.1868	capitaliz
[t-Score]	-1.2807	*-1.9550*	-1.2171	*-1.8440*	
%vhigh [est. coeff.]		0.1912		0.1605	%vhigh
[t-Score]		***4.1024***		***5.0770***	
%NC [est. coeff.]	0.1625	0.1064	0.1432	0.0865	%NC
[t-Score]	**2.4925**	*1.6110*	**2.3639**	1.3829	
vh+h+m [est. coeff.]	0.1096		*0.1076*		vh+h+m
[t-Score]	***2.7570***		***3.9710***		
Adj R-square	0.0843	0.1028	0.0864	0.1059	**Adj R-square**

Baltimore - Refinance

Variable					**Variable**
Intercept	-0.1032	-0.0535	-0.1591	-0.0692	Intercept
	-2.7780	-2.0886	-6.0809	-3.2914	
%black [est. coeff.]	0.1107	0.1016			%black
[t-Score]	***8.0671***	***6.7403***			
%hisp [est. coeff.]	-0.4806	-0.5125			%hisp
[t-Score]	**-2.2312**	**-2.3859**			
%65age [est. coeff.]	0.1307	0.1012			%65age
[t-Score]	**2.5661**	**2.2017**			
medage [est. coeff.]	0.0041	0.0044	0.0104	0.0096	medage
[t-Score]	0.8486	0.9049	**2.0732**	**1.9929**	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.2127	0.1780	0.3565	0.8598	
HT [est. coeff.]	-0.1173	-0.1081	-0.1724	-0.1429	HT
[t-Score]	***-4.3461***	***-4.0315***	***-5.9525***	***-5.1085***	
capitaliz [est. coeff.]	11.4350	11.0128	12.1084	10.2778	capitaliz
[t-Score]	***7.4773***	***7.0691***	***7.2380***	***6.2013***	
%vhigh [est. coeff.]		0.1915		0.4338	%vhigh
[t-Score]		***3.2109***		***9.8300***	
%NC [est. coeff.]	0.3391	0.2854	0.3476	0.2013	%NC
[t-Score]	***3.9410***	***3.2582***	***3.9729***	***2.2663***	
vh+h+m [est. coeff.]	0.1471		0.3089		vh+h+m
[t-Score]	***2.9374***		***8.0034***		
Adj R-square	0.6306	0.6320	0.5539	0.5801	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 3: Detailed Regressions for Cleveland

Cleveland - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0968	-0.0667	-0.2787	-0.1445	Intercept
	-2.4616	-2.6279	-9.6417	-6.9277	
%black [est. coeff.]	0.2400	0.2159			%black
[t-Score]	***15.6258***	***11.9307***			
%hisp [est. coeff.]	-0.0317	-0.0693			%hisp
[t-Score]	-0.5279	-1.1269			
%65age [est. coeff.]	0.0698	0.0496			%65age
[t-Score]	1.2876	1.0664			
medage [est. coeff.]	0.0114	0.0104	0.0029	0.0008	medage
[t-Score]	**2.1543**	**1.9885**	0.4430	0.1363	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.0055	0.5456	**2.3867**	***4.2976***	
HT [est. coeff.]	-0.0425	-0.0405	-0.2003	-0.1330	HT
[t-Score]	-0.8212	-0.7884	***-3.1160***	**-2.2735**	
capitaliz [est. coeff.]	8.3768	7.5255	10.5030	6.1981	capitaliz
[t-Score]	***5.2034***	***4.5995***	***5.1443***	***3.2482***	
%vhigh [est. coeff.]		0.2395		0.8201	%vhigh
[t-Score]		***3.3621***		***15.3546***	
%NC [est. coeff.]	0.1226	0.0691	0.2533	0.0019	%NC
[t-Score]	**2.2792**	1.2988	***4.0533***	0.0307	
vh+h+m [est. coeff.]	0.1274		0.5215		vh+h+m
[t-Score]	**2.2510**		***10.6801***		
Adj R-square	0.6865	0.6904	0.4906	0.5747	**Adj R-square**

Cleveland – Refinance

Variable					**Variable**
Intercept	-0.2596	-0.1557	-0.3936	-0.1729	Intercept
	-6.1378	-5.8013	-13.4316	-8.6214	
%black [est. coeff.]	0.1988	0.1238			%black
[t-Score]	***12.4492***	***6.7255***			
%hisp [est. coeff.]	0.0693	-0.0251			%hisp
[t-Score]	1.1136	-0.4123			
%65age [est. coeff.]	0.1635	0.1104			%65age
[t-Score]	***2.8461***	**2.2404**			
medage [est. coeff.]	0.0134	0.0094	0.0028	0.0019	medage
[t-Score]	**2.1879**	1.6132	0.3966	0.3124	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	-0.5386	1.0357	0.8153	***2.8402***	
HT [est. coeff.]	0.0142	0.0298	-0.2029	-0.0665	HT
[t-Score]	0.2246	0.4945	***-2.8433***	-1.0777	
capitaliz [est. coeff.]	16.4428	14.1417	16.9059	12.1840	capitaliz
[t-Score]	***9.4880***	***8.3802***	***8.4575***	***6.9456***	
%vhigh [est. coeff.]		0.7923		1.1672	%vhigh
[t-Score]		***10.3537***		***24.0454***	
%NC [est. coeff.]	0.3718	0.1896	0.4998	0.1288	%NC
[t-Score]	***5.9831***	***3.1951***	***7.5462***	**2.1248**	
vh+h+m [est. coeff.]	0.4403			0.8241	vh+h+m
[t-Score]	***7.0236***			***16.8755***	
Adj R-square	0.8108	0.8268	0.7400	0.8060	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 4: Detailed Regressions for Detroit

Detroit - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.1612	-0.0673	-0.2883	-0.1217	Intercept
	-6.5514	-4.5959	-15.3291	-10.5391	
%black [est. coeff.]	0.1661	0.1414			%black
[t-Score]	***17.3528***	***12.6615***			
%hisp [est. coeff.]	0.0645	0.0671			%hisp
[t-Score]	0.8549	0.8940			
%65age [est. coeff.]	0.1606	0.1108			%65age
[t-Score]	***4.5974***	***3.5032***			
medage [est. coeff.]	-0.0009	-0.0006	0.0073	0.0064	medage
[t-Score]	-0.2483	-0.1527	*1.6466*	1.5942	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***7.0185***	***7.2346***	***9.5542***	***11.2168***	
HT [est. coeff.]	-0.0487	-0.0422	-0.0668	-0.0487	HT
[t-Score]	***-2.7491***	***-2.3909***	***-3.1544***	***-2.5180***	
capitaliz [est. coeff.]	0.9817	0.2664	2.6210	-0.0667	capitaliz
[t-Score]	1.5908	0.4177	***3.6241***	-0.0964	
%vhigh [est. coeff.]		0.2817		0.5624	%vhigh
[t-Score]		***7.9450***		***21.2638***	
%NC [est. coeff.]	0.2134	0.0892	0.3806	0.0654	%NC
[t-Score]	***4.3575***	*1.7369*	***7.1284***	1.2392	
vh+h+m [est. coeff.]	0.2435		0.4483		vh+h+m
[t-Score]	***7.3623***		***15.2271***		
Adj R-square	0.6267	0.6302	0.4622	0.5494	**Adj R-square**

Detroit - Refinance

Variable					**Variable**
Intercept	0.0163	0.0239	0.0160	0.0166	Intercept
	1.2207	2.3102	0.7742	1.0967	
%black [est. coeff.]	0.2577	0.2578			%black
[t-Score]	***40.0263***	***40.0004***			
%hisp [est. coeff.]	0.1282	0.1295			%hisp
[t-Score]	***2.6175***	***2.6440***			
%65age [est. coeff.]	-0.0634	-0.0633			%65age
[t-Score]	***-2.2064***	***-2.2031***			
medage [est. coeff.]	0.0059	0.0059	0.0071	0.0070	medage
[t-Score]	1.6232	1.6277	1.2371	1.2299	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***-5.1794***	***-5.1494***	***-5.6100***	***-5.5512***	
HT [est. coeff.]	-0.0940	-0.0940	-0.1672	-0.1674	HT
[t-Score]	***-4.2685***	***-4.2686***	***-4.6023***	***-4.6095***	
capitaliz [est. coeff.]	12.4840	12.4769	21.6557	21.6289	capitaliz
[t-Score]	***25.9571***	***25.9340***	***32.1928***	***32.1477***	
%vhigh [est. coeff.]		0.0088		-0.0266	%vhigh
[t-Score]		0.4675		-0.8586	
%NC [est. coeff.]	-0.0270	-0.0244	-0.0912	-0.0518	%NC
[t-Score]	-0.9466	-0.6699	*-1.9387*	-0.8615	
vh+h+m [est. coeff.]	0.0190		-0.0006		vh+h+m
[t-Score]	0.9414		-0.0181		
Adj R-square	0.8993	0.8992	0.7224	0.7226	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 5: Detailed Regressions for Houston

Houston - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0716	-0.0121	-0.0638	0.0024	Intercept
	-2.3607	-0.6369	-2.4380	0.1439	
%black [est. coeff.]	0.0492	0.0061			%black
[t-Score]	***3.5117***	0.3776			
%hisp [est. coeff.]	-0.0260	-0.0244			%hisp
[t-Score]	-1.4890	-1.4337			
%65age [est. coeff.]	0.1597	0.1507			%65age
[t-Score]	***2.5969***	***2.5793***			
medage [est. coeff.]	-0.0021	-0.0009	0.0026	0.0037	medage
[t-Score]	-0.3409	-0.1577	0.5345	0.8384	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.9668	*1.6872*	1.0104	*1.9404*	
HT [est. coeff.]	-0.0030	0.0002	-0.0025	-0.0003	HT
[t-Score]	-1.0546	0.0876	-0.8813	-0.0933	
capitaliz [est. coeff.]	-0.3612	-1.4909	-1.0640	-2.2156	capitaliz
[t-Score]	-0.3971	-1.6291	-1.1510	**-2.5192**	
%vhigh [est. coeff.]		0.3416		0.3347	%vhigh
[t-Score]		***7.2297***		***9.3429***	
%NC [est. coeff.]	0.0590	-0.0969	0.0596	-0.1120	%NC
[t-Score]	1.0204	*-1.6705*	1.0468	**-1.9726**	
vh+h+m [est. coeff.]	0.2145		0.2307		vh+h+m
[t-Score]	***5.3134***		***6.4863***		
Adj R-square	0.1762	0.2121	0.1302	0.1969	**Adj R-square**

Houston - Refinance

Variable					**Variable**
Intercept	-0.2230	-0.1553	-0.4695	-0.2285	Intercept
	-4.2211	-4.7643	-8.2199	-7.2035	
%black [est. coeff.]	0.4058	0.3194			%black
[t-Score]	***17.8827***	***11.8561***			
%hisp [est. coeff.]	0.0694	0.0660			%hisp
[t-Score]	**2.2102**	**2.1770**			
%65age [est. coeff.]	0.2483	0.2632			%65age
[t-Score]	***2.2765***	***2.5762***			
medage [est. coeff.]	0.0397	0.0446	0.0859	0.0888	medage
[t-Score]	***3.7532***	***4.3637***	***8.0243***	***10.2813***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.2985	1.3561	0.9242	***2.9685***	
HT [est. coeff.]	-0.0296	-0.0227	-0.0206	-0.0101	HT
[t-Score]	***-6.1039***	***-4.6654***	***-3.2921***	*-1.8924*	
capitaliz [est. coeff.]	14.4833	11.5724	10.9087	4.9465	capitaliz
[t-Score]	***9.0106***	***7.1455***	***5.1527***	***2.8008***	
%vhigh [est. coeff.]		0.6078		1.2788	%vhigh
[t-Score]		***6.9964***		***18.2973***	
%NC [est. coeff.]	0.2893	-0.0187	0.5737	-0.2016	%NC
[t-Score]	***2.6597***	-0.1652	***4.0848***	-1.5846	
vh+h+m [est. coeff.]	0.3045		0.8178		vh+h+m
[t-Score]	***4.1601***		***10.1633***		
Adj R-square	0.7364	0.7529	0.5333	0.6690	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 6: Detailed Regressions for Los Angeles

Los Angeles - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0148	0.0871	-0.0453	0.0472	Intercept
	-0.5055	4.7543	-2.0613	3.4345	
%black [est. coeff.]	0.0434	0.0278			%black
[t-Score]	***3.7431***	**2.2361**			
%hisp [est. coeff.]	-0.0738	-0.0662			%hisp
[t-Score]	***-6.5858***	***-6.0490***			
%65age [est. coeff.]	-0.0702	-0.1048			%65age
[t-Score]	*-1.6689*	**-2.5966**			
medage [est. coeff.]	0.0094	0.0088	0.0066	0.0050	medage
[t-Score]	**2.1647**	**2.0267**	1.5305	1.1809	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.4378	0.8086	*1.7249*	***3.0392***	
HT [est. coeff.]	-0.0514	-0.0332	-0.0211	-0.0031	HT
[t-Score]	*-1.9595*	-1.2885	-0.8087	-0.1218	
capitaliz [est. coeff.]	-7.2678	-8.6568	-7.7193	-11.1339	capitaliz
[t-Score]	***-3.8854***	***-4.5039***	***-4.0284***	***-5.8148***	
%vhigh [est. coeff.]		0.3435		0.4428	%vhigh
[t-Score]		***7.7136***		***11.8946***	
%NC [est. coeff.]	0.1144	-0.0043	0.0208	-0.1125	%NC
[t-Score]	**2.4322**	-0.0945	0.5577	***-2.9010***	
vh+h+m [est. coeff.]	0.2952		0.3193		vh+h+m
[t-Score]	***7.3164***		***9.0717***		
Adj R-square	0.1407	0.1441	0.0644	0.0997	**Adj R-square**

Los Angeles - Refinance

Variable					**Variable**
Intercept [est. coeff.]	-0.0906	-0.0129	-0.1650	-0.0638	Intercept
	-4.3821	-1.0019	-9.8654	-6.2372	
%black [est. coeff.]	0.1378	0.1286			%black
[t-Score]	***16.9109***	***14.6106***			
%hisp [est. coeff.]	0.0280	0.0342			%hisp
[t-Score]	***3.5810***	***4.4814***			
%65age [est. coeff.]	0.0756	0.0452			%65age
[t-Score]	**2.5679**	1.6024			
medage [est. coeff.]	0.0091	0.0087	0.0194	0.0177	medage
[t-Score]	***2.9504***	***2.8080***	***5.8533***	***5.5704***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***3.0705***	***3.1206***	***3.3433***	***5.2530***	
HT [est. coeff.]	-0.0318	-0.0192	-0.0829	-0.0660	HT
[t-Score]	*-1.7193*	-1.0509	***-4.2070***	***-3.5052***	
capitaliz [est. coeff.]	5.5637	4.8410	7.4860	3.8030	capitaliz
[t-Score]	***4.2604***	***3.6001***	***5.1977***	***2.7021***	
%vhigh [est. coeff.]		0.2280		0.4768	%vhigh
[t-Score]		***7.3062***		***17.5866***	
%NC [est. coeff.]	0.1631	0.0799	0.2772	0.1393	%NC
[t-Score]	***4.9454***	**2.5321**	***9.9885***	***4.9591***	
vh+h+m [est. coeff.]	0.2113		0.3472		vh+h+m
[t-Score]	***7.4171***		***13.0532***		
Adj R-square	0.5252	0.5247	0.4009	0.4467	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 7: Detailed Regressions for Milwaukee

Milwaukee - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept [est. coeff.]	-0.0561	0.0130	-0.1595	-0.0106	Intercept
	-1.3438	0.3896	-5.7474	-0.4008	
%black [est. coeff.]	0.1844	0.1457			%black
[t-Score]	***6.8455***	***4.3336***			
%hisp [est. coeff.]	-0.0610	-0.0752			%hisp
[t-Score]	-0.6171	-0.7587			
%65age [est. coeff.]	0.0231	-0.0225			%65age
[t-Score]	0.4227	-0.4502			
medage [est. coeff.]	-0.0010	-0.0006	-0.0124	-0.0095	medage
[t-Score]	-0.1977	-0.1161	***-2.4492***	**-2.0155**	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	-0.3238	-0.6619	0.9549	0.5907	
HT [est. coeff.]	-0.1624	-0.1526	-0.1719	-0.1504	HT
[t-Score]	***-3.8946***	***-3.6747***	***-3.8059***	***-3.6134***	
capitaliz [est. coeff.]	3.8248	2.5950	7.2203	1.5137	capitaliz
[t-Score]	*1.6469*	1.0752	***2.9384***	0.6136	
%vhigh [est. coeff.]		0.2419		0.5094	%vhigh
[t-Score]		**3.3803**		***10.5301***	
%NC [est. coeff.]	0.0356	-0.0717	0.0597	-0.2022	% NC
[t-Score]	0.3727	-0.7106	0.6883	-2.2449	
vh+h+m [est. coeff.]	0.1751		0.3760		vh+h+m
[t-Score]	***3.1259***		***7.8538***		
Adj R-square	0.5929	0.5953	0.4931	0.5567	**Adj R-square**

Milwaukee - Refinance

Variable					**Variable**
Intercept [est. coeff.]	-0.1289	-0.0553	-0.3075	-0.0990	Intercept
	-3.3313	-1.9004	-9.9169	-4.1451	
%black [est. coeff.]	0.2913	0.2290			%black
[t-Score]	***13.4897***	***8.8845***			
%hisp [est. coeff.]	0.0253	-0.0129			%hisp
[t-Score]	0.3411	-0.1760			
%65age [est. coeff.]	0.0682	0.0207			%65age
[t-Score]	1.2791	0.4296			
medage [est. coeff.]	-0.0010	-0.0014	-0.0226	-0.0161	medage
[t-Score]	-0.2040	-0.2998	***-3.7912***	***-3.2240***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.9831	1.0871	**2.4469**	***3.0354***	
HT [est. coeff.]	-0.2229	-0.2103	-0.2733	-0.2261	HT
[t-Score]	***-5.4905***	***-5.3254***	***-5.1182***	***-5.0763***	
capitaliz [est. coeff.]	7.0170	5.3346	13.0116	5.1581	capitaliz
[t-Score]	***3.6779***	***2.7993***	***5.4563***	**2.4298**	
%vhigh [est. coeff.]		0.3505		0.7782	%vhigh
[t-Score]		***6.0860***		***18.1084***	
%NC [est. coeff.]	0.2398	0.1268	0.3423	0.0121	%NC
[t-Score]	***2.8523***	1.5293	***4.1184***	0.1611	
vh+h+m [est. coeff.]	0.2216		0.5925		vh+h+m
[t-Score]	***4.4829***		***11.8902***		
Adj R-square	0.8391	0.8470	0.7107	0.7952	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 8: Detailed Regressions for New York

New York - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					Variable
Intercept	-0.0831	-0.0156	-0.0693	-0.0026	Intercept
	-3.7671	-1.1341	-5.2760	-0.2874	
%black [est. coeff.]	-0.0028	-0.0333			%black
[t-Score]	-0.2905	***-2.9956***			
%hisp [est. coeff.]	-0.0176	-0.0175			%hisp
[t-Score]	-1.1753	-1.1991			
%65age [est. coeff.]	0.0245	-0.0133			%65age
[t-Score]	0.8318	-0.4858			
medage [est. coeff.]	0.0063	-0.0049	-0.0066	-0.0052	medage
[t-Score]	**-2.2128**	*-1.7481*	**-2.3241**	*-1.8580*	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.8508	1.2882	0.8606	0.9210	
HT [est. coeff.]	-0.0671	-0.0652	-0.0698	-0.0650	HT
[t-Score]	***-5.1135***	***-5.0214***	***-5.3603***	***-5.0273***	
capitaliz [est. coeff.]	4.5458	4.0967	4.5306	4.1659	capitaliz
[t-Score]	***4.6141***	***4.1908***	***4.6271***	***4.2846***	
%vhigh [est. coeff.]		0.3385		0.2506	%vhigh
[t-Score]		***8.6606***		***10.5744***	
%NC [est. coeff.]	0.1373	0.0628	0.1113	0.0342	%NC
[t-Score]	***3.1419***	1.4733	***3.0438***	0.8812	
vh+h+m [est. coeff.]	0.2211		0.2046		vh+h+m
[t-Score]	***7.0687***		***9.6398***		
Adj R-square	0.2235	0.2412	0.2237	0.2366	**Adj R-square**

New York - Refinance

Variable					Variable
Intercept	-0.3449	-0.0956	-0.3494	-0.1038	Intercept
	-15.0857	-5.5738	-16.6523	-7.0802	
%black [est. coeff.]	-0.0045	-0.0048			%black
[t-Score]	-0.5259	-0.5912			
%hisp [est. coeff.]	-0.0181	-0.0238			%hisp
[t-Score]	-1.3867	*-1.9461*			
%65age [est. coeff.]	-0.0054	-0.0127			%65age
[t-Score]	-0.1350	-0.3377			
medage [est. coeff.]	0.0244	0.0173	0.0246	0.0175	medage
[t-Score]	***4.8576***	***3.6681***	***5.0704***	***3.8485***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.9236	1.1906	0.9846	1.2698	
HT [est. coeff.]	-0.2578	-0.2235	-0.2623	-0.2303	HT
[t-Score]	***-5.0285***	***-4.6395***	***-5.1396***	***-4.7978***	
capitaliz [est. coeff.]	8.2697	5.9878	8.3394	6.0702	capitaliz
[t-Score]	***3.7790***	***2.9259***	***3.8197***	***2.9704***	
%vhigh [est. coeff.]		0.8740		0.8669	%vhigh
[t-Score]		***25.6367***		***25.5495***	
%NC [est. coeff.]	0.6245	0.3339	0.6313	0.3443	%NC
[t-Score]	***9.7477***	***5.2304***	***9.8874***	***5.4100***	
vh+h+m [est. coeff.]	0.7021		0.6974		vh+h+m
[t-Score]	***21.3501***		***21.3121***		
Adj R-square	0.5878	0.6363	0.5881	0.6358	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 9: Detailed Regressions for St. Louis

St. Louis - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.3851	-0.2098	-0.3840	-0.2093	Intercept
	-10.3472	-8.2588	-10.7522	-8.4073	
%black [est. coeff.]	0.0060	0.0068			%black
[t-Score]	0.5060	0.6852			
%hisp [est. coeff.]	0.2666	0.3189			%hisp
[t-Score]	1.2764	*1.6922*			
%65age [est. coeff.]	-0.0294	-0.0279			%65age
[t-Score]	-0.4692	-0.4977			
medage [est. coeff.]	0.0287	0.0140	0.0290	0.0148	medage
[t-Score]	***3.2903***	*1.7411*	***3.9000***	**2.1538**	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***5.2746***	***6.0803***	***5.2586***	***6.0563***	
HT [est. coeff.]	-0.2985	-0.2102	-0.3006	-0.2131	HT
[t-Score]	***-3.9183***	***-3.1781***	***-3.9678***	***-3.2254***	
capitaliz [est. coeff.]	10.5586	4.7064	10.6740	4.9026	capitaliz
[t-Score]	***4.6207***	**2.1910**	***4.7203***	**2.2988**	
%vhigh [est. coeff.]		0.8341		0.8276	%vhigh
[t-Score]		***12.1652***		***12.2001***	
%NC [est. coeff.]	0.5673	0.1533	0.5672	0.1557	%NC
[t-Score]	***6.4062***	*1.7063*	***6.4251***	*1.7330*	
vh+h+m	0.4893		0.4862		vh+h+m
[t-Score]	***7.3599***		***7.4763***		
Adj R-square	0.5441	0.6289	0.5453	0.6284	**Adj R-square**

St. Louis - Refinance

Variable					**Variable**
Intercept	-0.4462	-0.2706	-0.5173	-0.2867	Intercept
	-8.9409	-8.9943	-12.3150	-10.8358	
%black [est. coeff.]	0.1822	0.1405			%black
[t-Score]	***10.4092***	***8.0440***			
%hisp [est. coeff.]	0.2816	0.2517			%hisp
[t-Score]	0.7563	0.7189			
%65age [est. coeff.]	0.3065	0.2401			%65age
[t-Score]	***4.2338***	***3.7708***			
medage [est. coeff.]	0.0189	0.0192	0.0347	0.0322	medage
[t-Score]	***2.8394***	***3.0790***	***4.9275***	***5.2674***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***4.7326***	***5.0831***	***5.3023***	***5.8190***	
HT [est. coeff.]	-0.1380	-0.1004	-0.3125	-0.2252	HT
[t-Score]	*-1.8453*	-1.4468	***-3.7234***	***-3.0865***	
capitaliz [est. coeff.]	15.1680	12.6709	15.6756	11.5736	capitaliz
[t-Score]	***8.7029***	***7.5884***	***7.7473***	***6.3298***	
%vhigh [est. coeff.]		0.7636		1.0054	%vhigh
[t-Score]		***10.3399***		***14.6164***	
%NC [est. coeff.]	0.5985	0.2600	0.9368	0.3687	%NC
[t-Score]	***6.8804***	***2.9608***	***10.9743***	***4.0613***	
vh+h+m [est. coeff.]	0.5096		0.6599		vh+h+m
[t-Score]	***7.0111***		***9.2071***		
Adj R-square	0.8156	0.8368	0.7509	0.8032	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 10: Detailed Regressions for Washington, D.C.

Washington - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0921	-0.0403	-0.0839	-0.0303	Intercept
	-4.7182	-3.9111	-6.9137	-3.8307	
%black [est. coeff.]	0.0007	-0.0162			%black
[t-Score]	0.0815	*-1.9010*			
%hisp [est. coeff.]	-0.0230	-0.0117			%hisp
[t-Score]	-1.0384	-0.5382			
%65age [est. coeff.]	0.0415	0.0265			%65age
[t-Score]	1.6110	1.1546			
medage [est. coeff.]	0.0035	0.0043	0.0050	0.0034	medage
[t-Score]	1.4144	*1.7684*	**2.3703**	*1.6626*	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***6.7120***	***7.7899***	***7.4649***	***7.9575***	
HT [est. coeff.]	-0.0152	-0.0083	-0.0159	-0.0082	HT
[t-Score]	**-2.5370**	-1.4396	***-2.6972***	-1.4197	
capitaliz [est. coeff.]	2.7519	1.2741	2.8480	1.7619	capitaliz
[t-Score]	***3.2323***	1.4574	***3.4670***	**2.1306**	
%vhigh [est. coeff.]		0.2455		0.1992	%vhigh
[t-Score]		***8.2219***		***11.1844***	
%NC [est. coeff.]	0.1122	0.0371	0.1043	0.0239	%NC
[t-Score]	***4.0712***	1.5746	***4.7132***	1.0587	
vh+h+m [est. coeff.]	0.1611		0.1530		vh+h+m
[t-Score]	***5.8323***		***9.3834***		
Adj R-square	0.1876	0.2180	0.1853	0.2168	**Adj R-square**

Washington - Refinance

Variable					**Variable**
Intercept	-0.0885	-0.0067	-0.1401	-0.0285	Intercept
	-4.4291	-0.6134	-10.6061	-3.3379	
%black [est. coeff.]	0.0557	0.0522			%black
[t-Score]	***6.6773***	***6.0619***			
%hisp [est. coeff.]	-0.1044	-0.0916			%hisp
[t-Score]	***-4.7428***	***-4.1683***			
%65age [est. coeff.]	0.1105	0.0694			%65age
[t-Score]	***3.9719***	***2.7602***			
medage [est. coeff.]	0.0015	0.0014	0.0126	0.0094	medage
[t-Score]	0.6225	0.5641	***5.4239***	***4.2054***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	1.5437	0.4820	***3.1343***	**2.5557**	
HT [est. coeff.]	-0.0326	-0.0234	-0.0469	-0.0296	HT
[t-Score]	***-4.9534***	***-3.6294***	***-6.7679***	***-4.4176***	
capitaliz [est. coeff.]	5.3927	4.4650	4.8013	2.8950	capitaliz
[t-Score]	***6.2500***	***4.8876***	***5.3119***	***3.2051***	
%vhigh [est. coeff.]		0.2274		0.3725	%vhigh
[t-Score]		***7.3702***		***19.4870***	
%NC [est. coeff.]	0.0900	-0.0049	0.1492	0.0014	%NC
[t-Score]	***3.1698***	-0.2003	***6.0717***	0.0573	
vh+h+m [est. coeff.]	0.2006		0.3043		vh+h+m
[t-Score]	***7.2331***		***17.2681***		
Adj R-square	0.5908	0.5917	0.5151	0.5473	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 11: Summary of Regression Results

Home Purchase Lending

	Atl.	Balt.	Cleve.	Det.	Hous.	LA	Milw.	NYC	St. L.	D.C.
Variable										
%black	+++		+++	+++	+++	+++	+++			
%hisp						- - -				
%65age				+++	+++	-				
medage			++			++		- -	+++	
medhhinc	++			+++					+++	+++
HT				- - -		-	- - -	- - -	- - -	- -
capitaliz			+++			- - -	+	+++	+++	+++
NC		++	++	+++		++		+++	+++	+++
vh+h+m	+++	+++	++	+++	+++	+++	+++	+++	+++	+++
Adj R-square	0.4566	0.0843	0.6865	0.6267	0.1762	0.1407	0.5929	0.2235	0.5441	0.1876

Refinance Lending

	Atl.	Balt.	Cleve.	Det.	Hous.	LA	Milw.	NYC	St. L.	D.C.
Variable										
%black	+++	+++	+++	+++	+++	+++	+++		+++	+++
%hisp		- -		+++	++	+++				- - -
%65age	+++	++	+++	- -	++	++			+++	+++
medage			++		+++	+++		+++	+++	
medhhinc	+++			- - -		+++			+++	
HT		- - -		- - -	- - -	-	- - -	- - -	-	- - -
capitaliz	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++
NC	+	+++	+++		+++	+++	+++	+++	+++	+++
vh+h+m	+++	+++	+++		+++	+++	+++	+++	+++	+++
Adj R-square	0.6903	0.6306	0.8108	0.8993	0.7364	0.5252	0.8391	0.5878	0.8156	0.5908

\+ positive relationship
\- negative relationship
\+ or - 10% significance level
++ or - - 5% significance level
+++ or - - - 1% significance level

Table 12: Impact of Number of African-Americans in a Neighborhood

Percent African-Americans in a census tract

Home Purchase

	Estimated coefficient	Level of Significance	White/African-American Segregation Index
Cleveland	0.2400	***	79.7
Milwaukee	0.1844	***	84.4
Detroit	0.1661	***	86.7
Atlanta	0.1393	***	68.8
Houston	0.0492	***	71.8
Los Angeles	0.0434	***	70.5
Baltimore	0.0063		71.8
St. Louis	0.0060		78.0
Washington	0.0007		66.2
New York	-0.0028		84.3

Refinance

	Estimated coefficient	Level of Significance	White/African-American Segregation Index
Houston	0.4058	***	71.8
Milwaukee	0.2913	***	84.4
Detroit	0.2577	***	86.7
Cleveland	0.1988	***	79.7
Atlanta	0.1866	***	68.8
St. Louis	0.1822	***	78.0
Los Angeles	0.1378	***	70.5
Baltimore	0.1107	***	71.8
Washington	0.0557	***	66.2
New York	-0.0045		84.3

* - 10% level of significance
** - 5% level of significance
*** - 1% level of significance

The dissimilarity index varies between 0 and 100, and measures the percentage of one group that would have to move across neighborhoods to be distributed the same way as the second group. A dissimilarity index of 0 indicates conditions of total integration. A dissimilarity index of 100 indicates conditions of total segregation. For more information see www.CensusScope.org of the Social Science Data Analysis Network at the University of Michigan.

Table 13: Impact of Number of Hispanics in a Neighborhood

Percent Hispanics in a census tract

Home Purchase

	Estimated coefficient	Level of Significance	White/Hispanic Segregation Index
St. Louis	0.2666		36.7
Detroit	0.0645		48.3
New York	-0.0176		69.3
Washington	-0.0230		52.5
Houston	-0.0260		59.2
Cleveland	-0.0317		59.0
Milwaukee	-0.0610		60.6
Los Angeles	-0.0738	***	64.4
Baltimore	-0.0890		40.3
Atlanta	-0.2080		56.8

Refinance

	Estimated coefficient	Level of Significance	White/Hispanic Segregation Index
St. Louis	0.2816		36.7
Detroit	0.1282	***	48.3
Houston	0.0694	**	59.2
Cleveland	0.0693		59.0
Los Angeles	0.0280	***	64.4
Milwaukee	0.0253		60.6
New York	-0.0181		69.3
Washington	-0.1044	***	52.5
Atlanta	-0.2456		56.8
Baltimore	-0.4806	**	40.3

* - 10% level of significance
** - 5% level of significance
*** - 1% level of significance

The dissimilarity index varies between 0 and 100, and measures the percentage of one group that would have to move across neighborhoods to be distributed the same way as the second group. A dissimilarity index of 0 indicates conditions of total integration. A dissimilarity index of 100 indicates conditions of total segregation. For more information see www.CensusScope.org of the Social Science Data Analysis Network at the University of Michigan.

Table 14: Impact of Number of Elderly Residents in a Neighborhood

Percent People over 65		
Home Purchase		
	Estimated coefficient	Level of Significance
Detroit	0.1606	***
Houston	0.1597	***
Atlanta	0.0845	
Cleveland	0.0698	
Washington	0.0415	
Baltimore	0.0367	
New York	0.0245	
Milwaukee	0.0231	
St. Louis	-0.0294	
Los Angeles	-0.0702	*
Refinance		
	Estimated coefficient	Level of Significance
St. Louis	0.3065	***
Atlanta	0.2701	***
Houston	0.2483	**
Cleveland	0.1635	***
Baltimore	0.1307	**
Washington	0.1105	***
Los Angeles	0.0756	**
Milwaukee	0.0682	
New York	-0.0054	
Detroit	-0.0634	**

* - 10% level of significance
** - 5% level of significance
*** - 1% level of significance

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Written Testimony for Subcommittee on Financial Institutions and Consumer Credit

Subcommittee on Financial Institutions and Consumer Credit Hearing: "Home Mortgage Disclosure Act: Newly Collected Data and What It Means"

June 13, 2006

On behalf of the National Training and Information Center (NTIC), I thank the Subcommittee on Financial Institutions and Consumer Credit, the Honorable Rep. Spencer Bachus and the Honorable Rep. Bernie Sanders for the opportunity to submit comments on a matter of critical importance to our neighborhoods—new Home Mortgage Disclosure Act (HMDA) data.

In the 1970s, with the leadership of Gale Cincotta, NTIC spearheaded efforts to pass the Home Mortgage Disclosure Act (HMDA) and the Community Reinvestment Act (CRA). Knowing that any law is only as good as its implementation, NTIC has worked with banks throughout the country to ensure that people in low- and moderate-income communities were receiving access to credit as mandated by CRA. Gale Cincotta, "the mother of CRA" and the late director and co-founder of NTIC, thought that once the CRA passed the banks would be forced to do their job. Unfortunately, this is not the case. The CRA has encouraged many mainstream lenders to do business in low- and moderate-income areas, but subprime and predatory lenders are now thriving because they are able to maneuver around regulation and find creative ways to make money at the expense of consumers.

Just as it would be wrong to say that all lenders redline or engage in activities that are detrimental to borrowers, it is equally wrong to assume that without strong regulatory oversight all lenders will play by the rules and do what is right and beneficial to borrowers and neighborhoods. The Home Mortgage Disclosure Act had to be enacted before community groups could document and prove what neighborhood residents already knew, which was that financial institutions were redlining their neighborhoods and excluding them from access to loans. HMDA-based research led to the enactment of the Community Reinvestment Act in 1977, which outlawed redlining.

NTIC has been working with HMDA and the CRA to keep track of lenders in our neighborhoods to ensure they are serving the communities' credit needs. We work directly with community groups, banks, and banking regulators in this process. We bring community leaders from around the country to meet with the banking regulators to comment on HMDA and the CRA.

The HMDA has been critical in all of the work we have done to bring good sources of credit to low- and moderate-income neighborhoods in the country. NTIC commended the Federal Reserve Board for taking a critical step in understanding the subprime lending market by requiring lenders to report loan pricing information to the Home Mortgage Disclosure Act (HMDA). It is an important step that allows HMDA to keep pace with the rapidly modernizing financial industries.

The enhanced loan pricing information in HMDA will help bankers, government officials, and consumer groups check for the predatory lending practice of "steering." Steering occurs when a borrower is steered into a high-interest, "subprime" loan, even if the borrower's credit history is good. Fannie Mae estimates that 50 percent of borrowers who receive high-interest subprime loans actually qualified for a prime rate loan. Lenders are also not proactively finding borrowers the lowest cost of credit. The 2001 Fannie Mae National Housing Study found that 34 percent of borrowers were not informed by the lender of how they could qualify for a lower interest loan.

By collecting loan pricing information, community groups and regulators will be able identify irresponsible lenders who are overcharging borrowers for loans. A study published in December 2001 by NTIC, Slash and Burn Financing, focused on one subprime lender, CitiFinancial. It found that 39.1 percent of those surveyed, who reported having "good credit" (i.e. they never made a late payment or defaulted on a mortgage loan) and reported their interest rate, received loans with interest rates ranging between 14 and 22 percent.

Disclosure of interest rates and fees are critical to protecting borrowers. Interest rates in today's subprime mortgage market are supposedly determined by the risk of the borrowers as determined by the borrower's credit record. In order to guard against overcharging and steering, lenders must be required to disclose the interest rate for every loan they make. Fees are also often inflated for subprime borrowers. While banks charge an average of one to two percent (Paul Neal, Freddie Mac Director of Sales/Alternative Channels, Presentation at Home Equity Fraud and Predatory Mortgage Lending Conference, 1999), predatory lenders charge fees ranging from three to 20 percent. High fees strip equity from a homeowner's investment, often leading to default and foreclosure. Lenders who overcharge fees can be exposed by the additional loan pricing information in HMDA.

NTIC provides HMDA analysis for grassroots community organizations at no cost. We are using the enhanced HMDA to help community groups bring good credit to low and moderate income communities. This is the true purpose of both the HMDA and the CRA—to help bring credit to underserved neighborhoods. We need to continue to use these vital pieces of regulation and legislation and not weaken them.

Attached is an example from Cincinnati, OH of the information that we are able to provide to community organizations about lending in their communities. The organization uses this data, analysis and maps in meetings with bankers, regulators and other community stakeholders. HMDA is a vital tool in all efforts to increase homeownership opportunities, particularly in low- and moderate-income and minority communities.

Respectfully submitted,

Joseph W. Mariano
Executive Director

2004 HMDA Report: Cincinnati, OH

Porportion of High Priced Home Loans by Census Tracts

Prepared by NTIC Research Department for Communities United for Action, February 2006

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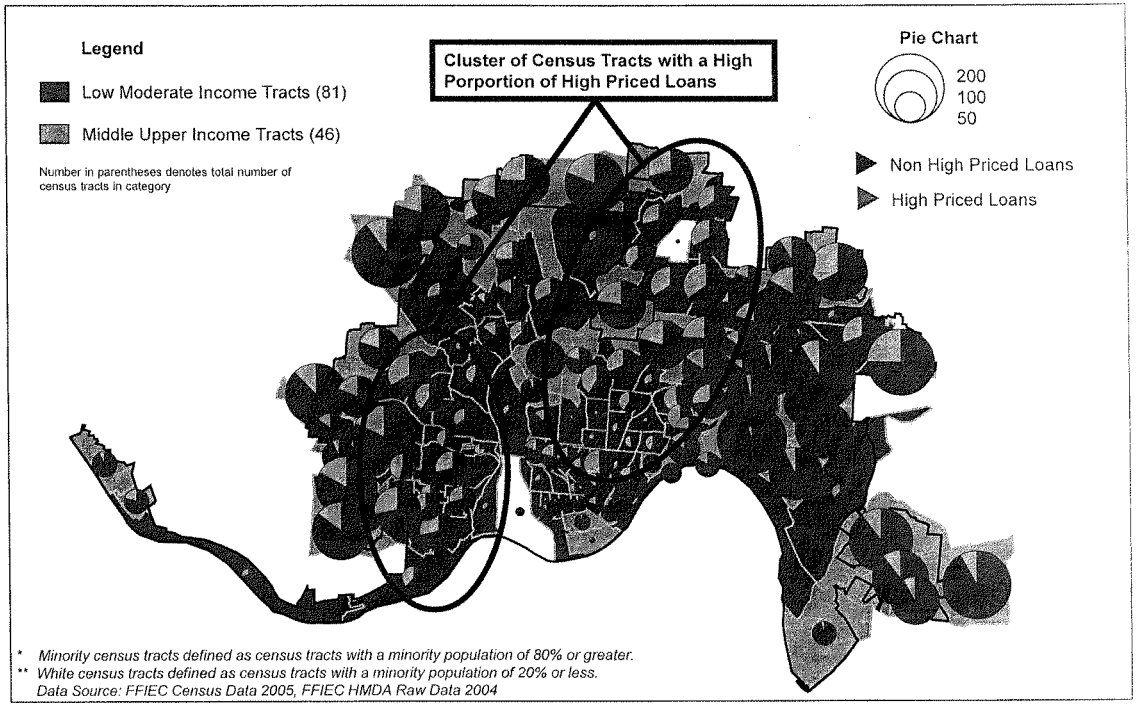


* *Minority census tracts defined as census tracts with a minority population of 80% or greater.*
** *White census tracts defined as census tracts with a minority population of 20% or less.*
Data Source: FFIEC Census Data 2005, FFIEC HMDA Raw Data 2004

HMDA 2004 Reportfor City of Cincinnati, OH

Conventional Loan Origination and Denial Rates by Applicant Race and Income

Prepared by National Training and Information Center for Communities United for Action

Based on HMDA 2004 data released by the Federal Financial Institutions Examination Council

2000 Cenus Data: # of Households.148,095, White Population: 53%, Black Population:43%

	White Applicants					
Applicant Income Level	Applications	Originations	Origination Rates	Denials	Denial Rate	Percent of Originations High Cost
Low	1671	895	53.56%	626	37.46%	20%
Moderate	3372	2199	65.21%	793	23.52%	17%
Middle	3189	2222	69.68%	682	21.39%	13%
Upper	3286	2500	76.08%	505	15.37%	6%
NA	498	352	70.68%	97	19.48%	4%
Totals	**12016**	**8168**	**67.98%**	**2703**	**22.50%**	

	African-American Applicants					
Applicant Income Level	Applications	Originations	Origination Rates	Denials	Denial Rate	Percent of Originations High Cost
Low	1442	585	40.57%	693	48.06%	40%
Moderate	1867	862	46.17%	744	39.85%	40%
Middle	1170	578	49.40%	418	35.73%	35%
Upper	602	303	50.33%	223	37.04%	27%
NA	115	42	36.52%	51	44.35%	19%
Totals	**5196**	**2370**	45.61%	**2129**	**40.97%**	

	Hispanic Applicants					
Applicant Income Level	Applications	Originations	Origination Rates	Denials	Denial Rate	Percent of Originations High Cost
Low	34	13	38.24%	17	50.00%	21%
Moderate	67	45	67.16%	15	22.39%	20%
Middle	65	48	73.85%	13	20.00%	17%
Upper	69	46	66.67%	16	23.19%	2%
NA	9	7	77.78%	2	22.22%	0%
Totals	**244**	**159**	**65.16%**	**63**	**25.82%**	

	Applicants of Another Race					
Applicant Income Level	Applications	Originations	Origination Rates	Denials	Denial Rate	Percent of Originations High Cost
Low	40	19	47.50%	15	37.50%	20%
Moderate	72	41	56.94%	21	29.17%	15%
Middle	72	48	66.67%	15	20.83%	15%
Upper	107	89	83.18%	15	14.02%	4%
NA	11	5	45.45%	4	36.36%	0%
Totals	**302**	**202**	**66.89%**	**70**	**23.18%**	

	Applicants with Unreported Race					
Applicant Income Level	Applications	Originations	Origination Rates	Denials	Denial Rate	Percent of Originations High Cost
Low	620	183	29.52%	358	57.74%	43%
Moderate	797	296	37.14%	385	48.31%	39%
Middle	656	264	40.24%	286	43.60%	32%
Upper	559	292	52.24%	185	33.09%	13%
NA	252	137	54.37%	108	42.86%	5%
Totals	**2884**	**1172**	**40.64%**	**1322**	**45.84%**	

*Data includes loans for the following purpose: Home purchase, Home improvement, and Refinancing

U. S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0001

THE SECRETARY

June 8, 2006

The Honorable Barney Frank
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515-6050

Dear Representative Frank:

Thank you for your letter concerning the 2004 Home Mortgage Disclosure Act (HMDA) data. As you are aware, the Federal Reserve provided the Department of Housing and Urban Development with its evaluation of this data and identified lenders with significant disparities in loan pricing for white and minority borrowers.

HUD has reviewed the study by the Federal Reserve Board and has conferred with the Federal Trade Commission, the Department of Justice, and other federal regulatory agencies on the findings of the study. HUD has also assembled a team within the Department consisting of fair housing investigators, economists, and attorneys to plan the possible investigation of individual lenders. At the team's request, the Federal Reserve has conducted additional analysis of the 2004 HMDA data, and HUD economists have contributed additional analysis. HUD is using a variety of factors to determine which lenders may be the subject of a HUD Secretary-initiated investigation. HUD is identifying which lenders, if any, on the list were the subject of past HUD complaints or have been identified by HUD partners as engaging in possible lending discrimination. HUD is also considering the volume of loans made by the lender, the locations where the lender has made loans, and the degree of pricing disparities, based on race and national origin. If HUD decides to conduct a Secretary-initiated investigation of any lender, HUD will obtain additional information from that lender regarding the credit histories of individual borrowers and the overall practices of the mortgage company in determining whether the lender has violated the Fair Housing Act.

Thank you for your interest in the Department's programs.

Sincerely,

Alphonso Jackson

U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

June 1, 2006

The Honorable Barney Frank
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Frank:

This is in response to your letter to Attorney General Gonzales concerning certain lending institutions identified by the Board of Governors of the Federal Reserve ("Federal Reserve") as having statistically significant disparities between white and minority borrowers in the proportion of loans with interest rates above specified levels ("higher-priced loans"). The Federal Reserve's study was based on 2004 data submitted by most mortgage lenders under the Home Mortgage Disclosure Act (HMDA). You have asked for information about the process being used by the Department of Justice ("Department") to evaluate whether any of the identified lending institutions are in violation of fair lending laws. Please excuse our delay in responding.

The Department enforces various federal civil rights laws, two of which proscribe discrimination in mortgage lending. The Fair Housing Act, 42 U.S.C. § 3601 *et seq.*, prohibits discrimination in residential real estate-related transactions, including loans and other financial assistance, on the basis of race, color, religion, national origin, sex, familial status and disability. The Equal Credit Opportunity Act, 15 U.S.C. § 1691, *et seq.*, prohibits creditors from discriminating in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, or because an applicant receives income from a public assistance program.

In September 2005, Federal Reserve staff published a study of the 2004 HMDA data entitled, "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," 2005 Federal Reserve Bulletin 344. As part of that study, the Federal Reserve compared each lender's white and minority borrowers to determine whether there were statistically significant disparities in the rate at which each group received higher-priced loans or the interest rates charged for such loans, as well as comparing several other loan characteristics including the rate at which applications for home loans were denied. In the study, the Federal Reserve noted that it found approximately 200 lenders with statistically significant disparities in the rate at which white and minority borrowers received higher-priced loans, which disparities could not be explained by the data available in the HMDA reports. The Federal Reserve shared

information regarding its study and the identified lenders with the Department, the banking regulatory agencies, and other government agencies with the authority to enforce fair lending requirements.

In deciding whether to initiate an investigation of a particular lender, the Department evaluates the information from the Federal Reserve study, along with a variety of other information, and conducts its own analysis of the HMDA data. To date, we have opened investigations of several lenders, contacted those lenders, and requested additional information regarding their business practices, loan products and loan data. While we cannot discuss details of ongoing investigations, we would note that all of the lenders currently under investigation are cooperating with the Department.

These investigations are ongoing, and we continue to evaluate whether enforcement action is appropriate. We also continue to review all available information to determine if additional investigations should be opened. We are coordinating our efforts with those of other federal agencies, as appropriate, to ensure that the federal government enforcement efforts in these areas are as efficient and effective as possible.

We hope this information is helpful. Please do not hesitate to contact the Department if we can be of assistance in other matters.

Sincerely,

William E. Moschella

William E. Moschella
Assistant Attorney General

Comptroller of the Currency
Administrator of National Banks

April 27, 2006

The Honorable Barney Frank
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Frank:

I am pleased to respond to your letter to me dated March 17, 2006, concerning the Office of the Comptroller of the Currency's (OCC's) use of Home Mortgage Disclosure Act (HMDA) data as a screening tool in our fair lending compliance oversight of national banks. In particular, you ask about the process the OCC follows to evaluate the compliance of national banks that are identified as having statistically significant disparities based on the 2004 HMDA data, including those banks identified by the Federal Reserve Board in its initial screening of these data for all lenders.[1]

At the OCC, our fair lending supervision for national banks and their operating subsidiaries ("national banks') entails a process of ongoing fair lending risk assessments and periodic in-depth fair lending examinations. The supervisory offices for each national bank conduct ongoing risk assessments during each supervisory cycle, including compliance risk. Each assessment conducted by the OCC includes a *fair lending risk assessment* to determine the quantity of fair lending risk and the quality of fair lending risk management. The scope of a fair lending assessment depends on a wide range of factors that may include prior examination findings, changes in the bank's business lines or lending practices, consumer complaints, and the adequacy of, and any changes to, its compliance risk management system. This assessment helps the examiners establish a supervisory strategy, scope, and schedule that is appropriate to the level of risk that has been identified.

The OCC supervisory offices also select national banks each year for in-depth *fair lending examinations* using our fair lending risk screening process. This annual screening process supplements the ongoing oversight for fair lending risk at national banks described above. The

[1] As noted in former Chairman Greenspan's letter to you dated January 30, 2006, responding to your request for a list of the names of lenders identified by the Federal Reserve as having significant loan-pricing differences in 2004, "these results represent an initial screening, do not in themselves prove violations of fair lending laws at any institution, and are considered confidential information that is part of the supervision and enforcement process."

OCC fair lending screening process uses a number of criteria to identify fair lending risk, including the risks of discrimination in loan underwriting, discrimination in loan terms and conditions, discrimination in loan pricing, discrimination in loan marketing, and of redlining. Information from these screens not only helps to identify the banks that will undergo a fair lending examination, but also helps to shape the scope, or focus, of the examinations. In addition, a number of national banks are selected each year for fair lending examinations based on a random selection process.

The HMDA data significantly influence the OCC's identification of fair lending risks in mortgage lending by national banks. However, HMDA data are by no means the only indicators of fair lending risk. Other information that is considered in our screening process includes information developed through our examiner risk assessments described above; consumer complaints received by our Customer Assistance Group (CAG); comments on fair lending performance by national banks we receive from the public in the course of our community outreach activities; information from government entities; and other information that bears on a national bank's fair lending compliance.

As part of our fair lending screening process, the OCC reviewed a list of banks provided to us in September 2005 by the Federal Reserve Board, in connection with our own initial analysis of the HMDA data, to identify those institutions whose pricing data suggested the need for a closer look. We carefully evaluated the fair lending compliance risks at each of the banks on this list. Of the roughly four-dozen national bank entities on the Federal Reserve list, most had already been identified by the OCC's screening process as having potential fair lending compliance risks.

A few of the banks that appeared on the Federal Reserve list were not selected for an in-depth fair lending examination this year.[2] We viewed these banks as presenting a low degree of pricing discrimination risk because a majority of their higher cost loans were made to non-minorities, their level of higher cost lending to minorities was low, and they did not exhibit other indicia of fair lending risks in our internal screening process. In addition, two banks that appeared on the Federal Reserve list are no longer subject to our jurisdiction, having been acquired by non-OCC regulated institutions.

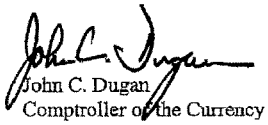
For those banks on the final lists produced by the OCC's processes, augmented by the data provided by the Federal Reserve, as described above, many examinations are underway, and have been completed. In these examinations for potential discrimination in loan pricing decisions, examiners -- in consultation with OCC lawyers and statistical modeling experts, where appropriate -- conduct a comparative file review. When the volume of applications is sufficient, more complex statistical analysis may be used to assist our evaluation of the banks' lending record. HMDA data are valuable inputs into these processes -- in helping examiners identify loan files for review and in providing some of the data elements to be reviewed. Many other qualitative factors are considered in this type of analysis, of course, that are not included in the HMDA data, to permit a more comprehensive evaluation of the lending practices under review

[2] As Mr. Greenspan noted in his letter to you, "The Federal Reserve has not identified a particular level of statistical significance of denial or price disparities shown by HMDA data that, by itself, would trigger a heightened or more detailed fair lending review."

and to provide the basis for a determination about compliance with the fair lending laws. These include an analysis of the bank's underwriting and pricing criteria, borrower credit characteristics, credit scores, debt-to-income ratios, and loan-to-value ratios. If, after this review, loan pricing disparities remain that have not been determined to be the result of objective, nondiscriminatory credit criteria, bank management will be presented with the OCC's findings and given an opportunity to respond. If the bank cannot provide a satisfactory explanation for these disparities, the violations will be documented in the examination report and decisions will be made on referrals to the Department of Justice and/or HUD, as well as on what other OCC enforcement or supervisory actions should be taken.

I share your interest in ensuring that statistical disparities in the HMDA data and other indicators of fair lending compliance risk are used effectively by the bank regulatory agencies to identify lending practices that violate the fair lending laws. I hope that this has been responsive to your questions about the OCC's fair lending compliance process in this regard. If you have any further questions, please do not hesitate to contact me.

Sincerely,



John C. Dugan
Comptroller of the Currency

Office of Thrift Supervision
Department of the Treasury

John M. Reich
Director

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6590

MAY 24 2006

May 16, 2006

The Honorable Barney Frank
Ranking Member
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Frank:

This is in response to your March 17, 2006 inquiry regarding institutions within our jurisdiction that the Board of Governors of the Federal Reserve System (FRB) indicates demonstrate statistically significant disparities in mortgage lending based on the 2004 HMDA data submitted to the FRB under the Home Mortgage Disclosure Act (HMDA). In particular, you ask for an explanation of our process for evaluating the HMDA data disparities along with the status of our review of these cases.

As you note, statistical HMDA data disparities alone are not conclusive evidence of discriminatory mortgage lending practices. HMDA data do not include certain determinants of credit risk that lenders consider in pricing mortgage loan products, such as a borrower's credit history, loan-to-property-value ratio, and consumer debt-to-income ratio. Thus, while HMDA data disparities may suggest a need for closer evaluation of a lender, additional credit data is required in order to determine whether the lender may be unlawfully discriminating against certain borrowers.

In its analysis of the 2004 HMDA data forwarded to us, the FRB identified savings associations with statistically significant disparities in at least one mortgage product. Our process for evaluating these institutions consisted of several steps. At the outset, OTS staff contacted management at each of the institutions and provided them copies of the FRB analysis. The institutions were asked to respond to the FRB's findings. We also conducted on-site visits at these institutions to review internal assessments, as well as third party assessments, of the institutions' compliance with fair lending laws and regulations. Finally, we requested and reviewed all additional credit data considered by the lenders in their pricing of mortgage loan products highlighted in the FRB's HMDA data analysis.

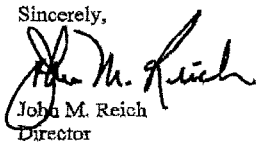
In connection with our review of the institutions highlighted in the FRB's 2004 HMDA data, we were able to eliminate statistically significant pricing disparities for all of the institutions we regulate based on our analysis of the additional credit information used by these institutions to price the mortgage loan products highlighted in the FRB's analysis. In all of the

cases we reviewed, the objective factors in the additional credit information explained the disparities identified by the FRB's analysis. As a result, we concluded that there was no evidence of unlawful discrimination and closed our review of these institutions.

Aside from our review conducted pursuant to the FRB's analysis of the 2004 HMDA data, please be advised that OTS periodically reviews the mortgage pricing policies and procedures of the institutions we regulate during our regularly scheduled fair lending examinations of each institution. These reviews are conducted pursuant to the Federal Financial Institutions Examination Council's Interagency Fair Lending Examination Procedures.

If we may provide you with any additional information regarding this matter, please feel free to contact me directly at 202-906-6590, or Kevin Petrasic, Managing Director, External Affairs, at 202-906-6452. Thank you.

Sincerely,



John M. Reich
Director

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

April 20, 2006

Honorable Barney Frank
Ranking Minority Member
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Congressman Frank:

Thank you for your letter regarding the Federal Deposit Insurance Corporation's review of the 2004 Home Mortgage Disclosure Act (HMDA) data to identify violations of fair lending laws.

During 2005, the FDIC had numerous discussions with the Federal Reserve involving proper screening techniques for the 2004 HMDA data. As a result of those discussions, the FDIC developed its own screening techniques to identify FDIC institutions that exhibit an unusually high risk of pricing discrimination against one or more racial/ethnic minority groups or females and, as a result, identified additional institutions not flagged by the Federal Reserve screens. The data of each of these institutions is receiving increased scrutiny to determine whether discriminatory or other illegal credit practices may exist. These reviews, which began in 2005, are assessing not only the 2004 data but also any subsequent HMDA data collected by the institutions. For those institutions that we have not been able to resolve the questions about their data, the FDIC has scheduled on site examinations to commence no later than the end of this year.

The FDIC will not tolerate unlawful credit discrimination by the institutions we supervise. When pattern or practice violations of the Equal Credit Opportunity Act are identified, we make the required referrals to the U.S. Department of Justice (DOJ). We then coordinate with DOJ to require institutions to provide appropriate relief for the victims and to take the actions necessary to ensure that the violations do not recur.

Thank you for your interest in this important issue. If you have further questions, Alice Goodman, our Director of Legislative Affairs, can be reached at 898-8730.

Sincerely,

Martin J. Gruenberg

Martin J. Gruenberg
Acting Chairman

National Credit Union Administration

Office of the Chairman

March 31, 2006

Honorable Congressman Barney Frank
U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Frank:

I am responding to your letter dated March 17, 2006, regarding the Agency's analysis of HMDA data. The National Credit Union Administration (NCUA) evaluates credit unions having statistically significant disparities in their 2004 Home Mortgage Disclosure Act (HMDA) data as reported by the Federal Reserve Board (FRB).

Of the 200 financial institutions identified by the FRB as having significant differences in their 2004 HMDA data, two were credit unions. Typically, NCUA will conduct a full fair lending examination or an on-site review at credit unions having statistically significant differences in their data. Both credit unions identified by the FRB were referred to our regional offices for additional review including an on-site visit. During our on-site review, we noted errors on the loan application registers but both credit unions have filed corrected reports for 2005. Overall, our reviews did not indicate any pattern or practice of discrimination and we found that the credit unions treated applicants fairly with no evidence of disparate treatment.

Credit unions must collect HMDA data throughout the calendar year and file the data with the Federal Reserve Board by March 1st of the following calendar year. NCUA takes these HMDA filing requirements seriously. In 2005, the Agency issued orders of assessment of civil money penalties against 18 federally insured credit unions for late submissions of data required by HMDA. The amount of the civil money penalties collected against these credit unions totaled $220,250.

It is our Agency's goal to encourage credit unions to provide quality services such as loans to all qualified groups or individuals who desire them. We also understand the importance of collecting HMDA data and will continue take necessary action against late filers.

Thank you for your interest in this very important area.

Sincerely,

JoAnn Johnson

JoAnn Johnson
Chairman

EI:LKM/lm

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HMDA Disparities or Discrimination?

GREGORY D. SQUIRES

In their analysis of the new HMDA data ("New Information Reported Under HMDA and Its Application in Fair-Lending Enforcement," *Federal Reserve Bulletin*, summer 2005), Federal Reserve Board researchers document substantial racial disparities in the cost of credit.

But after laying out the basic patterns, the paper quickly backtracks in efforts to explain away the uncomfortable findings.

A basic message that comes through is the possibility, if not likelihood, that with sufficient data on the right "objective" measures the racial disparity would disappear. And if this were the case, according to this perspective, the problem of racial discrimination would virtually disappear, except perhaps within a few selected institutions.

The notion that the presence or absence of a statistically significant race coefficient in a multivariate model is the touchstone for determining whether racial discrimination is present, however, is wrongheaded and dangerous. (I'm reminded of the statistical joke that if you torture the data long enough, eventually they will surrender.)

Though the race effect has probably not disappeared (the National Community Reinvestment Coalition found race statistically significant in previous lending studies, even after controlling for credit rating and housing characteristics), its disappearance would not be the end of the discussion. It would simply be the beginning of a much more complex discussion about the continuing role of race in credit markets and American society in general.

But if controlling for income, wealth, property characteristics, credit rating, type of loan, loan-to-value ratio, type of lender, and the rest resulted in a race coefficient that was zero or not statistically significant, this raises many questions and answers few.

If the race effect disappeared in this manner, it would mean that the large unadjusted disparities could be "explained" by the fact that racial minorities earn less money, accumulate less wealth, purchase homes in worse repair, have lower reported (but often inaccurate) credit ratings, need to borrow a higher share of the cost of their housing, and are limited to fewer but higher priced lenders.

All of this raises the question of why.

Part of the answer, no doubt, is that minorities on average attend inferior schools, which reduces their ability to compete in the labor market, undercutting their income and potential wealth accumulation.

Employers still systematically discriminate (as the economists Marianne Bertrand and Sendhil Mullainathan reported in "Are Emily and Greg More Employable than Lakisha and Jamal? A Field Experiment on Labor Market Discrimination," published last year in *The American Economic Review*). Such discrimination in education and employment no doubt contributes to the fact that minorities generally have higher loan-to-value ratios and lower credit scores.

Discrimination in the nation's housing markets continues to limit choices for racial minorities and the appreciation in the value of the homes they are able to buy.

Though discrimination may have been reduced in the 1990s, the latest HUD/Urban Institute housing-discrimination study found that African-Americans and Latinos encounter disparate treatment in one out of every five initial visits to a rental or sales agent. Historical and ongoing segregation continues to restrict options for racial minorities on a range of fronts, as Douglas S. Massey and Nancy A. Denton documented in their classic book "American Apartheid" and as fair-housing researchers and advocates continue to document.

Segregation continues to lead to fewer housing options and lower wealth accumulation associated with homeownership, inferior neighborhood public schools, higher neighborhood crime rates, fewer job opportunities, and a range of factors that contribute to socioeconomic failure.

One consequence of this panoply of conditions is that property values, and therefore property tax revenues, are suppressed. This of course leads to even fewer resources available to finance public education, which reinforces the process of neighborhood decline and perpetuates this vicious cycle over generations.

Many factors contribute to these patterns. Among them are historical, if not contemporary, practices by financial service providers that at least up until no more than two generations ago overtly and explicitly redlined urban neighborhoods and minority borrowers.

These practices, often nurtured by public policy, created the wide-ranging forms of racial inequality that apparently are now used to justify "unadjusted" racial disparities in mortgage lending.

The point is not to place the entire blame for racial inequality on financial service providers. But it is critical to understand that even if lenders are simply responding objectively to the objective risks that various borrowers present today, this does not mean racial discrimination is irrelevant or that lenders have no culpability.

The Fed's analysis does acknowledge its role in pursuing further investigations if the HMDA data reveal particularly large disparities for selected institutions. Its paper notes a range of steps the Fed might take in these circumstances.

But those steps do not include paired testing — equally qualified white and nonwhite "mystery shoppers" approaching the same service providers to see if they are treated differently — perhaps the most effective and efficient tool for documenting racial discrimination.

Testing has been used by other enforcement agencies and researchers to document discrimination in home rentals and sales, property insurance, automobile sales, other commercial businesses, and mortgage lending. The Fed's resistance to using this tool undercuts its ability to pursue discrimination cases, even in the few instances where it may be inclined to do so.

Racial discrimination, of course, is much more complicated than simply the interaction between two actors in which one intentionally refuses to serve the other because of race. Intentional discrimination rooted in overt prejudice has been reduced in recent years. But the institutional context that has long nurtured racial inequality has not changed as much and still yields unequal and unfair outcomes, as indicated by the disparities in the cost of credit for various racial groups documented by the new HMDA data.

This is part of why CRA and related tools remain essential, and why we cannot allow the presence or absence of a statistically significant race coefficient to be the sole determinant of whether race remains a problem in credit markets.

Mr. Squires is a professor of sociology, public policy, and public administration at George Washington University in Washington.

ABOUT VIEWPOINTS

Viewpoints is a regular feature in *American Banker*, appearing every Friday and at other times throughout the year. It serves as a forum for discussion and debate on a wide range of issues in financial services, including management approaches and strategies, legislative and regulatory matters, and public policy in general.

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